S. HRG. 98-443

HONEST BUDGETING ACT OF 1983

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

S. 1679

TO AMEND THE FEDERAL FINANCING BANK ACT OF 1973 TO REQUIRE THAT PROGRAMS FINANCED THROUGH THE FEDERAL FINANCING BANK BE INCLUDED IN THE FEDERAL BUDGET, TO REQUIRE THAT CERTAIN TYPES OF OBLIGATIONS BE OFFERED FOR SALE TO THE BANK, AND FOR OTHER PURPOSES

SEPTEMBER 19, 1983

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE
26-196 O WASHINGTON : 1983

S241-7

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

JAKE GARN, Utah, *Chairman*

JOHN TOWER, Texas
JOHN HEINZ, Pennsylvania
WILLIAM L. ARMSTRONG, Colorado
ALFONSE M. D'AMATO, New York
SLADE GORTON, Washington
PAULA HAWKINS, Florida
MACK MATTINGLY, Georgia
CHIC HECHT, Nevada
PAUL TRIBLE, Virginia

WILLIAM PROXMIRE, Wisconsin
ALAN CRANSTON, California
DONALD W. RIEGLE, JR., Michigan
PAUL S. SARBANES, Maryland
CHRISTOPHER J. DODD, Connecticut
ALAN J. DIXON, Illinois
JIM SASSER, Tennessee
FRANK R. LAUTENBERG, New Jersey

M. DANNY WALL, *Staff Director*
KENNETH A. MCLEAN, *Minority Staff Director*

CONTENTS

MONDAY, SEPTEMBER 19, 1983

	Page
Opening statement of Senator Trible	1
Bill being considered, S. 1679	3
Opening statement of Senator Proxmire	6

WITNESSES

Slade Gorton, U.S. Senator, Washington	7
Prepared statement	9
Joseph Wright, Deputy Director, Office of Management and Budget	14
Prepared statement	17
Rudolf Penner, Director, Congressional Budget Office	31
Budgetary treatment of FFB financing	32
Honest Budgeting Act of 1983	33
Prepared statement	36
Direct loans should appear in a unified budget	54
Credit programs of Federal Government ignored	55
Response to written questions from the committee	57
Pete Domenici, U.S. Senator, New Mexico	64
FFB off-budget financing distorts budget	64
Prepared statement	67
Responses to questions on S. 1679	74
Impact of off-budget FFB financing	75
Lawton Chiles, U.S. Senator, Florida:	
Prepared statement	76
The REA excluded from the legislation	83
Harry Havens, Assistant Comptroller General, General Accounting Office	84
Prepared statement	87

AFTERNOON SESSION

Guy C. Lewis, Jr., President, National Rural Electric Cooperative Association	93
Prepared statement	95
Reasons for REA to remain off-budget	104
Jim Sasser, U.S. Senator, Tennessee	105
Charles Dean, Chairman of the Board, Tennessee Valley Authority	107
Prepared statement	110
TVA raises funds through FFB or private sector	115
TVA is self-sustaining; no cost to taxpayers	116
Response to additional questions from Senator Sasser	119
Ron Utt, Deputy Chief Economist, U.S. Chamber of Commerce	123
Additional proposals offered by Chamber of Commerce	124
Prepared statement	126
Elmer B. Statts, former Comptroller General of the United States, Committee for Economic Development, accompanied by Frank Schiff	140
Prepared statement	141
Capital budget items need longer term framework look	167
The National Lending Fund proposal	169

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

Letter submitted by Mortgage Bankers Association of America	172
Additional comments by the National Association of Manufacturers	174

HONEST BUDGETING ACT OF 1983

MONDAY, SEPTEMBER 19, 1983

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 10 a.m., in room SD–538, of the Dirksen Senate Office Building, Senator Paul S. Trible, Jr., presiding.

Present: Senators Trible, Gorton, Hecht, Proxmire, and Sasser.

OPENING STATEMENT OF SENATOR TRIBLE

Senator TRIBLE. Good morning, the full Committee on Banking, Housing, and Urban Affairs will come to order.

This morning we are here for hearings on Senate bill 1679, the Honest Budgeting Act of 1983.

A large part of the spending activities of the Federal Government does not show up in the Federal budget. It's off-budget and, therefore, largely obscure from congressional oversight. The outlays of the Federal Financing Bank comprise most of the off-budget outlays of the Federal Government. In less than 10 years, the Federal Financing Bank has financed $97 billion in off-budget spending.

That spending is Federal spending. It belongs in the budget. Creative accounting and off-budget spending on such a massive scale creates many serious problems. Every year, for example, actual Federal spending and Federal deficits are seriously underreported by the unified budget totals—by $21 billion in 1981, by $14 billion in 1982 and by about $14 billion this year. Congress and the public are seriously misled.

There are other problems as well.

Federal agencies can spend millions of dollars, and yet are not charged for the outlays. Programs with equal budget numbers are actually wildly unequal, hindering Congress severely in the national setting of budget priorities and the allocation of scarce Federal dollars. Programs authorized by Congress as loan guarantees are turned into direct Federal loans. Congressional constraints on individual programs are circumvented.

All these problems result from budget accounting procedures which Congress created. Only Congress can correct the situation.

The Honest Budgeting Act of 1983, Senate bill 1679, would require the transactions of the Federal Financing Bank to be reflected in the unified budget. The Federal budget would, therefore, accurately reflect the fiscal operations of the Federal Government. Further budget authority and outlays for Federal spending programs financed by the FFB would be charged to responsible agen-

cies' budget totals. Programs financed through the FFB would continue to be financed through the bank in the future.

Finally, other long loan programs, including new programs, could be financed with the FFB, providing that their budget authority and outlays would be attributed to the responsible agency and correctly reflected in the unified budget.

What then does all this mean? This legislation would accomplish a number of important objectives. It would make the unified Federal budget a more accurate reflection of the fiscal operations. It would greatly assist the formulation of tax and spending policy. It would eliminate the present understatement of Federal spending, lending and borrowing now associated with programs financed by the Federal Financing Bank. It would insure that loan programs which involve equal Federal outlays would appear as equal Federal budget documents and it would strengthen congressional control of Federal credit.

All this means our Government and limited national resources would be more effectively and efficiently managed, and that is our objective today.

At the outset, let me commend Senator Proxmire and Senator Gorton for their leadership in this matter. They have pointed the way for this legislation. This legislation, in effect, is a 1983 update of legislation they put forward in the last Congress. Senator Proxmire.

[Copy of bill being considered follows:]

98TH CONGRESS
1ST SESSION

S. 1679

To amend the Federal Financing Bank Act of 1973 to require that programs financed through the Federal Financing Bank be included in the Federal budget, to require that certain types of obligations be offered for sale to the Bank, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JULY 26 (legislative day, JULY 25), 1983

Mr. TRIBLE (for himself, Mr. GARN, Mr. PROXMIRE, Mr. GORTON, Mr. DOMENICI, Mr. ARMSTRONG, Mr. MATTINGLY, and Mr. HECHT) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To amend the Federal Financing Bank Act of 1973 to require that programs financed through the Federal Financing Bank be included in the Federal budget, to require that certain types of obligations be offered for sale to the Bank, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Honest Budgeting Act of 1983".

REPEAL OF BUDGET EXEMPTION

SEC. 2. Section 11(c) of the Federal Financing Bank Act of 1973 (12 U.S.C. 2290(c)) is amended to read as follows:

"(c) All transactions of the Bank shall be reflected in the unified budget of the United States Government. Amounts of loans which are guaranteed by a Federal agency and which are financed by the Bank shall be recorded as outlays of that agency and shall not exceed amounts of budget authority provided to that agency for such purpose. Amounts which are disbursed by the Bank for the purchase of loans guaranteed, loan assets sold, and debt obligations issued, by a Federal agency shall be treated as a means of financing that agency. The Director of the Office of Management and Budget shall issue regulations to carry out the provisions of this subsection.".

LIMITATIONS ON AGENCY FINANCING

SEC. 3. Section 7 of the Federal Financing Bank Act of 1973 (12 U.S.C. 2286) is amended by adding at the end thereof the following:

"(d) A Federal agency may not issue, sell, or guarantee an obligation of a type which was, during the period beginning October 1, 1981, and ending September 30, 1984, issued, sold, or guaranteed, and financed through the Bank unless that obligation is first offered for sale to the Bank. The

Secretary of the Treasury shall issue regulations to carry out the provisions of this subsection.".

EFFECTIVE DATE

SEC. 4. (a) The amendments made by this Act shall take effect on October 1, 1984.

(b) The amendments made by this Act shall not be deemed to be superseded, modified, or repealed except by a provision of law which is enacted after the date of enactment of this Act, and which amends the Federal Financing Bank Act of 1973.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. Thank you very much, Mr. Chairman.

Mr. Chairman, I certainly congratulate you on your title. I think you have got a nice new twist here. It was called the Truth-in-Budgeting Act; you call it the Honest Budgeting Act. I think honest may have more force than truth. I hope so, because we haven't been able to get this put into law, though it certainly should be.

You know, I can't think of a more important economic issue that Congress is faced with, as you say so well, than to put our fiscal policy in order. This Government, as we know, is borrowing over $200 billion this year to finance the colossal, record-shattering deficit. That borrowing competes with the economy of the private sector. All of us have met with our home builders, dealers, auto dealers and auto buyers, farmers, and small businessmen, all of whom are hurt badly by these high interest rates and particularly by the threat of continuing deficits.

These deficits are probably going to increase interest rates and increase them to a level higher than they were a year or two ago, when they were at scandalous levels, because the Federal Government is going to be competing so stringently with the private sector. In this context, it seems to me it is essential that we have an honest budget, a truthful budget, a budget that genuinely reflects the borrowing by the Federal Government, as well as the spending by the Federal Government.

We don't have that now. We won't have it, unless we put the Federal Financing Bank into the budget.

Let me finally say, as I see the purpose of the legislation is twofold. First we want to see that all activities have been properly recorded in the budget and are on the books of the borrowing agency. Second, we want to preserve the role of the Federal Financing Bank as a central borrowing agent, so that we do not resurrect all of the problems that led to the establishment of the bank in 1973.

As we move foward with the legislation, I hope we can carefully balance these two objectives. If we simply put the Federal Financing Bank back in the budget and do nothing more, the end result could be that the Federal agencies would resume issuing their own guaranteed objections in the market at a much higher ultimate cost to the taxpayer.

I am delighted to see that our lead witness is appropriately the distinguished Senator from Washington, Senator Gorton, who has been an enthusiast advocate and author of legislation like this in the past.

Senator TRIBLE. Thank you, Senator Proxmire.

It is indeed a great pleasure to welcome our distinguished colleague, the senior Senator from the State of Washington. Senator Gorton is an active and constructive member of the Senate Budget Committee, has chaired the temporary task force on Federal credit, has cosponsored this legislation. Therefore, it is quite appropriate that he be our lead-off witness this morning. Senator Gorton.

STATEMENT OF SLADE GORTON, U.S. SENATOR FROM THE STATE OF WASHINGTON

Senator GORTON. Thank you, Mr. Chairman. I'm pleased at this opportunity to appear before the committee, not as a member, but as a witness, to testify in favor of S. 1679, the Honest Budgeting Act of 1983.

As you know, the issue of the Federal credit budgeting is a special interest of mine. Last year I chaired the Temporary Subcommittee or the Budget Committee that examined the budget effects of Federal credit activities, and made recommendations for improved budgeting treatment of those activities. S. 1679 embodies several of these recommendations, and I heartily endorse it as an important step forward in the Federal budget process. S. 1679 is similar to S. 711, which Senator Proxmire and I introduced earlier this year, and I hope the Banking Committee will report this legislation favorably, and at an early date.

The usefulness of the Federal budget depends upon its reflecting accurately the nature and extent of the Federal Government's financial position and policies. Unfortunately, the budget, as it is currently drafted, falls short of this goal in several ways. As a consequence, the budget figures which the Budget Committee works with during its annual deliberation, and which are prominently reported in the press, provide an incomplete picture of both the size and the composition of Federal economic activity.

Two important problems arise because of the budgetary treatment of certain credit transactions carried out by the Federal Financing Bank. First, the purchase by the FFB from Federal agencies of securities representing participation in a pool of assets, called certificates of beneficial ownership, cause outlays for lending in the agency budget to be understated by the amount of said purchases. Consequently, the unified Federal deficit is also understated by an equal amount. There is no justification for this treatment. It is a violation of generally accepted accounting principles, and is counter to the recommendation of the President's Commission of Budget Concepts, promulgated during the Johnson administration.

The second problem arises out of FFB purchases of loans guaranteed by other Federal agencies. In this case, the Federal Government, in effect, makes a loan which never appears as an outlay on the Federal budget. This second problem would not arise, if the guaranteed loan were by a private lender, although the subsidiary question of how we account for loan guarantees would remain. FFB participation, however, renders the transaction indistinguishable from an agency loan, and it should be treated as such.

Unlike the first problem, which arises because Congress has been inconsistent in following budget accounting principles, the second problem is more subtle, and arises because the budget principles are not quite adequate to the task for accounting for certain Government financial transactions.

S. 1679 corrects both of these problems and represents an important step toward improving the utility of the Federal budget. Furthermore, it corrects the problems in a proper fashion by attributing the economic activity to the Federal agency which is ultimately responsible for initiating it. It avoids the often suggested, but theo-

retically incorrect, solution of simply treating the FFB as the agency and incorporating its outlays into the Federal budget. This latter is an important point. I emphasize that the problem is not the FFB itself. Since its establishment in 1974, it has shown itself to be an effective mechanism for marketing the obligations of various Federal agencies in an orderly manner. It has resulted in savings to the Federal Government by virtue of its ability to finance debt at a lower rate than would otherwise be possible.

Furthermore, I also wish to emphasize that my support for S. 1679 is in no way an attack upon the several Federal agencies which use FFB financing, and whose agency budget treatment would be affected by this legislation. I simply wish to assure that our accounting treatment of agency transactions is consistent, and that the budget reflects accurately, the Federal Government activity in this area. Without accurate accounting information, it is impossible for Congress to make an informed decision about budget issues.

Passage of S. 1679 would be an important step toward fulfilling the recommendations made by the temporary task force on Federal credit of the Budget Committee, and also the recommendations embodied in this year's first concurrent budget resolution. It would also insure that the existence of the FFB financing mechanism itself would be natural with respect to the budget. This is a condition of the FFB charter which is presently not being met because of its purchase of guaranteed agency loans. S. 1679 is also highly complementary to my own proposal for a Federal credit budget in S. 1582.

I concur in the suggestion which is to be made by Senator Domenici with respect to the clarification of the budget statement of the Rural Electrification Agency. I am sympathetic with the underlying goal of incorporating presently off-budget activities into the unified budget. I believe, however, that it might be wise to pursue the particular issue of the REA separately from S. 1679, since it involves specific separate legislation which is under the jurisdiction of the Agriculture Committee.

Even with this modification, S. 1679 would improve the accuracy of the REA's agency budget—that is, it's off-budget budget—although it would leave open the question of it being incorporated into the unified Federal budget.

In conclusion, I believe S. 1679 to be a good bill which will significantly improve budget accounting and assist the Budget Committee and the Congress in its annual task. I urge this committee to report favorably this legislation.

[The complete statement follows:]

STATEMENT OF SENATOR SLADE GORTON BEFORE BANKING COMMITTEE

S. 1679 -- HONEST BUDGETING ACT OF 1983

SEPTEMBER 19, 1983

I am pleased, Mr. Chairman, at the opportunity to appear before this committee not as a member, but as a witness, to testify in support of S. 1679, the Honest Budgeting Act of 1983.

As you know, the issue of federal credit budgeting is a special interest of mine. Last year I chaired a Temporary Subcommittee of the Budget Committee that examined the budget effects of federal credit activities, and made recommendations for improved budgeting treatment of those activities. S. 1679 embodies several of these recommendations, and I heartily endorse it as an important step forward in the federal budget process. S. 1679 is similar to S. 711, which Senator Proxmire and I introduced earlier this year, and I hope the Banking Committee will report this legislation favorably, and at an early date.

The usefulness of the federal budget depends upon its reflecting accurately the nature and extent of the federal government's financial position and policies. Unfortunately, the budget as it is currently drafted falls short of this goal in several ways. As a consequence, the budget figures which the Budget Committee works with during its annual deliberations, and which are prominently reported in the press, provide an incomplete picture of both the size and composition of federal economic activity.

Two important problems arise because of the budgetary treatment of certain credit transactions carried out by the Federal Financing Bank. First, the purchase of the FFB from federal agencies of securities representing participation in a pool of assets, called Certificates of Beneficial Ownership, cause outlays for lending in the agency budget to be understated by the amount of such purchase. Consequently, the unified federal deficit is also understated by an equal amount. There is no justification for this treatment. It is a violation of generally accepted accounting principles, and is counter to the recommendation of the President's Commission of Budget Concepts, promulgated during the Johnson Administration.

The second problem arises out of FFB purchases of loans guaranteed by other federal agencies. In this case, the federal government in effect makes a loan which never appears as an outlay on the federal budget. This second problem would not arise if the guaranteed loan were made by a private lender, although the subsidiary question of how to account for loan guarantees would remain. FFB participation, however, renders the transaction indistinguishable from an agency loan, and it should be treated as such. Unlike the first problem, which arises because Congress has been inconsistent in following budget accounting principles, this second problem is more subtle, and arises because the budget principles are not quite adequate to the task of accounting for certain government financial transactions.

S. 1679 corrects both of these problems, and represents an important step toward improving the utility of the federal budget. Furthermore, it corrects the problems in the proper fashion, by attributing the economic activity to the federal agency which is ultimately responsible for initiating it. It avoids the often suggested, but theoretically incorrect, solution of simply treating the FFB as the agency, and incorporating its outlays into the federal budget.

This latter is an important point. I emphasize that the problem is not the FFB itself. Since its establishment in 1974, it has shown itself to be an effective mechanism for marketing the obligations of various federal agencies in an orderly manner, and has resulted in savings to the federal government by virtue of its ability to finance debt at a lower rate than would otherwise be possible. Furthermore, I also wish to emphasize that my support for S. 1679 is in no way an attack upon the several federal agencies which use FFB financing, and whose agency budget treatment would be affected by this legislation. I simply wish to assure that our accounting treatment of agency transactions is consistent, and that the budget reflects accurately federal government activity in this area. For without accurate accounting information, it is impossible for Congress to make informed decisions about budget issues.

Passage of S. 1679 would be an important step toward fulfilling the recommendations made by the Temporary Task Force on Federal Credit of the Budget Committee, and also the recommendations embodied in this year's First Concurrent Budget Resolution. It would also ensure that the existence of the FFB financing mechanism itself would be neutral with respect to the budget. This is a condition of the FFB charter which is presently not being met because of its purchase of guaranteed agency loans. S. 1679 is also highly complementary to my own proposal for a federal credit budget in S. 1582.

I do concur in the suggestion made a moment ago by Senator Domenici with respect to the clarification of the budget treatment of the Rural Electrification Agency (REA). I am sympathetic with the underlying goal of incorporating presently off-budget activity into the unified budget. I think, however, that it might be wise to purse the particular issue of the REA separate from S. 1679, since it involves specific separate legislation which is under the jurisdiction of the Agriculture Committee. Even with this modification, S. 1679 would improve the accuracy of the REA's agency budget -- that is, its off-budget budget -- although it would leave open the question of its incorporation into the unified federal budget.

In conclusion, I believe S. 1679 to be a good bill that will significantly improve budget accounting and assist the Budget Committee and the Congress in its annual task. I urge this Committee to report favorably this legislation.

# # #

Senator TRIBLE. Senator Gorton, thank you for your presentation this morning. You speak not only as a member of this Banking Committee, but as a member of the Senate Budget Committee, as well, and therefore, lend a special perspective to our hearing today. I fully agree with your statement, that to be truly effective, the budget process must report the full nature of its activities. That, of course, is our objective here today, to simply bring this information together, so that we, in turn, can make intelligent decisions on behalf of the American people. Senator Proxmire.

Senator PROXMIRE. Senator Gorton, as you know, I agree with you wholeheartedly on this. The one part of your presentation that disturbs me, though, is your thought that we might exclude the REA. Senator Domenici has the same thought. He says: "I would prefer Congress address this as a separate issue to amend the REA Act rather than change the FFB Act."

I think that's a formula for keeping REA off-budget. I think the world of the Rural Electrification Administration. All of us recognize that if it were not for the REA, we wouldn't have made anything like the progress we did in bringing our agriculture into the electricity age and making it as productive as it has been. It was a magnificent job.

On the other hand, I can't, for the life of me, see how we can make an exception for any operation. I'm afraid if we go through the Agriculture Committee, which is what we would have to do here—they were the ones who kept REA out of the budget—it means we're never going to include it. I realize that keeping REA in the bill makes it hard for this legislation to get through but I think you have to face that tough problem and insist that there be no exceptions. If you make an exception for REA, it seems to me it's going to be very hard to have a consistent, comprehensive bill.

Senator GORTON. Senator, from a theoretical point of view, it's not only difficult to disagree with you, it's, for all practical purposes, impossible. You, however, have been a member of this body far longer than the chairman and I have, and you have held these views. You have expounded those views eloquently during your entire time in the Senate. Because this bill is very likely to be referred into the Budget Committee, in addition to this committee, it seems to me as it did to the chairman of the Budget Committee, wiser to recognize the reality, the reality that it was unlikely that the bill could be reported or passed while it dealt with this subject, and our view was that it was better to take the single entity which falls into the general category with which this bills deals, which has created the most controversy in the Budget Committee itself, and separate it out for consideration in a different bill, simply because we are quite serious, as I know you are, about the necessity for the kind of improvements which are represented by S. 1679 or by the bill which you and I introduced. Because it was our feeling that the chances of success were so much greater handling it in this fashion that it would be in a way which, from a conceptual standpoint is almost certainly preferable.

Senator PROXMIRE. Senator Gorton, that reminds me of Alexander Pope's observation in "Rape of the Lock," when he said, "He would have ravished her, which but for a timely compliance, she prevented."

It seems to me, in this case, it might be wise for us to consider two approaches. I think you are undoubtedly right from a realistic standpoint as to the actions the Budget Committee might take. Supposing the Banking Committee referred the bill, after acting on it, to the Budget Committee, which I understand we are going to do, and the Budget Committee had their own amendment, so that then the Senate could decide on the floor with a vote to support the position that you think is realistic, the position that I think is more consistent.

Senator GORTON. That's a little harder play to call, but it is certainly not out of the realm of reason by any manner.

Senator PROXMIRE. Thank you, sir.

Senator TRIBLE. Senator Hecht.

Senator HECHT. I have no questions.

Senator TRIBLE. Senator Gorton, we thank you very much for being here this morning and for your presentation and your active support of this measure. Why don't you come up and join us now as a member of the committee?

Senator GORTON. Thank you, Mr. Chairman.

Senator TRIBLE. We are expecting this morning, Senator Domenici to testify on behalf of this measure. He is not yet here, so let's go on then to Mr. Joseph Wright, Deputy Director of the Office of Management and Budget.

Welcome, Mr. Wright. Glad to have you with us this morning.

JOSEPH WRIGHT, DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. WRIGHT. Thank you, Mr. Chairman. I have a prepared testimony, which I will submit for the record, and very briefly summarize, if I may.

Senator TRIBLE. Your full testimony will be made a part of the record. We invite you to make whatever remarks you deem appropriate.

Mr. WRIGHT. Thank you. In general, Mr. Chairman, the administration is in favor of S. 1679, and would very definitely like to work with you, the staff and the committee on some technical amendments that we think would be appropriate in order to achieve the goals that I think both you and we would like to see in this bill. We feel that it's time that all transactions of the FFB be reflected in the unified Federal budget, that outlays are charged to agencies that are using the FFB, and that the outlays not exceed the budget authority provided to those agencies.

And generally, we agree with the statement that you made, Mr. Chairman, I believe, when you introduced the bill on July 26. You stated that the legislation first would close significant budget accounting loopholes, and second would make the unified Federal budget a much more accurate reflection of the fiscal operations of the Federal Government. Further, the bill would eliminate the present understatement of Federal spending, and would provide a more precise measurement of the impact of Federal borrowing on the Nation's credit markets. It would charge Federal agencies for outlays for which they are responsible, by insuring that the loan programs that involve Federal outlays and repayments would

appear in the budget documents. This would strengthen the congressional control of all direct Federal loans.

A major priority, as you know, Mr. Chairman, of this administration has been greater control of Federal credit activity. As you can see on page 4 of my testimony, where I present a table of net Federal credit activity and total funds advanced and raised, this entire area of activity has been growing rapidly.

I might direct your attention down to the line that's called "Advanced under Federal auspices." This is lending which went up from $27 billion in 1975 to $87.7 billion in 1982, and then is projected to jump dramatically by the end of this fiscal year to $131 billion. That means that we're running on participation ratio from lending that was as low as 9.3 percent in 1976, and ranged in the 10-, 15-percent area until 1978 to almost double that, in the 20- to 21-percent range in 1982.

"Federal borrowing from the public," which is the next line down, was $135 billion in 1982 and is projected to rise to $216 billion in 1983 in these estimates. The guaranteed borrowing went up more than 2½ times, from $20.9 billion in 1982 to almost $56 billion in 1983; and the Government-sponsored enterprise borrowing went from $32.8 billion in 1982 to $53.5 billion in 1983. In other words, Mr. Chairman, Federal and federally assisted borrowing went up from $200 billion in 1982 to $325 billion, basically, in one year.

That means a participation ratio that was as low as 18.9 percent in 1979, is now approaching 50 percent.

Now, the off-budget outlays have been a problem, as you mention in your statement introducing the bill. On my table on page 5, I show that the FFB started in 1974, but in 1975, the first real full year of operation, outlays were in the $6 billion range for 2 years, went up to $21 billion in 1981, then declined to $14 billion in 1982, and $14 billion again in 1983. As you know, FFB outlays comprise most of the off-budget outlays in total.

One of the reasons for the growth of FFB outlays is that they are not subject to the same budgetary review as on-budget outlays. Therefore we think that, over the years, this has made it very easy for agencies to increase their lending outlays.

The assets of the FFB are shown on page 6. I have divided them up into three categories. First is "Agency debt"; at the end of June 1983, it was $28.7 billion.

The two larger categories, "Loan assets purchased from agencies" and "Loans directly made to the public," are the ones that we have serious problems with. Basically they are a way of avoiding outlays' being recorded in the budget. Loan assets purchased from the agencies are at $58.6 billion, and loans made directly to the public are $44.7 billion.

The major users of the FFB are shown on page 7. Farmers Home Administration and REA are the two primary users; between the two of them, outlays are $9.4 billion out of $14.1 billion in 1982.

Mr. Chairman, we believe that to gain budgetary control cash flows must be measured for all uses. And the past use of the FFB is the greatest evasion of the cash flow concept in the unified budget.

On pages 9 and 10, I basically show a table illustrating the different budgetary treatment for programs such as the CCC fund, the Agricultural credit insurance fund, Eximbank and several others.

What I am trying to show here is just a strong dichotomy in terms of how these programs are handled between on-budget and off-budget treatment. You see on page 10 that of those that I have listed in terms of net loan outlays, 61 percent are off-budget; and of the direct loans outstanding for those particular categories, 69 percent are off-budget. Mr. Chairman, there is no defensible reason for mixing the on- and off-budget lending transactions that have been illustrated in that table.

I would emphasize, however, that placing the FFB outlays on budget does not solve the problem of credit control, and, if anything, we believe the credit budget must be strengthened. It's the only mechanism that we have of monitoring all Federal credit activity. This bill is a very good start, and would be an important part of strengthening the unified budget's treatment of several lending programs.

For all of the above reasons, we support the basic provisions of S. 1679. There are a few essential amendments we think are important and we want to work with you on them. In section 2 of the bill, for example, we're concerned—as I believe, the Treasury is—that an internal Federal transaction might be double counted.

In section 3, we would like to strengthen the securities "of a type" language that refers to securities you have for existing, new, and revised programs. Our mutual goal is to make sure that all proper securities come within the provisions of S. 1679.

Mr. Chairman, I would be more than happy to answer any questions you may have.

[The complete statement follows:]

FOR RELEASE ON DELIVERY
EXPECTED AT 10:30 A.M.
MONDAY, SEPTEMBER 19, 1983

STATEMENT OF JOSEPH R. WRIGHT
DEPUTY DIRECTOR
OF THE OFFICE OF MANAGEMENT AND BUDGET
BEFORE THE SENATE COMMITTEE ON BANKING,
HOUSING, AND URBAN AFFAIRS

Mr. Chairman and Members of the Committee:

I am here today to present the Administration's view of S. 1679, a bill that would require the transactions of programs financed by the Federal Financing Bank to be reflected in the Federal budget.

The Honest Budgeting Act of 1983

The "Honest Budgeting Act of 1983" requires that all transactions of the Federal Financing Bank (FFB) be reflected in the unified Federal budget, instead of being excluded as they are under current law. The bill requires that outlays incurred on behalf of Federal agencies will be charged to these agencies and shall not exceed amounts of budget authority provided to these agencies. It further provides that amounts disbursed by the Bank shall be treated as a means of financing the responsible agency. Finally, agencies would not be permitted to borrow directly from the private credit markets by issuing obligations of the same type as those financed through the FFB between October 1, 1981, and September 30, 1984, without first offering those obligations to the FFB.

This bill would greatly improve the review and control of Federal outlays by both the Congress and the Executive branch by including the outlays of FFB-financed programs in the budget totals and by charging those outlays to the responsible agency. It would help prevent agencies from avoiding the budgetary control process by financing their programs through fully guaranteed obligations issued in the private credit markets. Thus, it would improve budgetary control while maintaining the principle of efficient debt management that was the original intent in setting up the Federal Financing Bank.

The Administration supports this bill, with some important reservations involving the types of obligations that should be covered by this bill. We believe these issues can be resolved and we expect to work closely with Congress in resolving them.

Federal Credit Activity

A major priority of this Administration has been greater control over Federal credit activity. In 1982, Federal and federally assisted lending was 21% of all funds advanced by nonfinancial sectors in the U.S. credit markets. This is well above the range of 10 to 15% that had prevailed for many years until 1978. Between 1978 and 1982, total direct loans and guaranteed loans outstanding increased by 99%, from $347 billion to $689 billion.

In 1982, Federal and federally assisted borrowing was $200 billion, or 49% of all funds raised by nonfinancial sectors in U.S. credit markets. This is the highest participation rate since World War II and is a large increase since

the early 1970's. From 1970 to 1974, for example, Federal and federally assisted borrowing averaged $32 billion per year, and was 21% of all funds raised. The participation rate has thus more than doubled since that time. The following table shows the growth in Federal and federally assisted borrowing and lending since 1975.

The growth of agency programs financed by the FFB was a major contributor to the increase in Federal borrowing. In 1982, the FFB outlays amounted to 10.4% of Federal borrowing from the public. It is crucial that this large and largely hidden, use of Federal credit be controlled effectively in order to encourage economic recovery and strong future growth.

One means of controlling this activity is the Federal credit budget, which measures the total amount of new credit activity. The Administration is committed to improving and strengthening the credit budget. An important complementary means towards the goal of greater control over credit, however, would be to attribute outlays to the individual programs that are supported by FFB lending on their behalf. This is achieved by S. 1679. This would lead to greater control over all outlays, as well as credit-related outlays.

Size and Growth of FFB Spending

The problem of control posed by the present budgetary treatment of programs financed by the FFB applies to a large and rapidly growing volume of Federal activity. As shown in the following table, FFB outlays more than doubled from $6.4 billion in 1975, the first full year of operation, to $14.1 billion in 1982.

NET FEDERAL CREDIT ACTIVITY AND TOTAL FUNDS ADVANCED AND RAISED
(dollars in billions)

	1975	1976	1977	1978	1979	1980	1981	1982	Estimates 1983	Estimates 1984
Direct loans: 1/										
On-budget	5.8	5.3	2.6	8.6	6.0	9.5	5.2	9.1	5.2	(0.3)
Off-budget	7.0	9.3	9.0	11.2	13.6	14.7	20.9	14.3	14.4	10.4
Total direct loans	12.8	14.6	11.6	19.8	19.6	24.2	26.1	23.4	19.6	10.1
Guaranteed loans	8.6	11.0	13.5	13.4	25.2	31.6	28.0	20.9	55.8	48.9
Government-sponsored enterprise loans (GSEs)	5.6	3.0	11.7	25.2	28.1	24.1	32.4	43.4	55.5	56.2
Advanced under Federal auspices	27.0	28.6	36.8	58.4	72.9	79.9	86.5	87.7	130.9	115.2
Total funds advanced in U.S. credit markets 2/	177.9	307.9	308.3	383.4	426.4	366.4	427.2	408.7	N/A	N/A
Participation ratio (%)	15.2	9.3	11.9	15.2	17.1	21.8	20.2	21.5	N/A	N/A
Federal borrowing from the public	50.9	100.9	53.5	59.1	33.6	70.5	79.3	135.0	216.0	194.0
Guaranteed borrowing	8.6	11.0	13.5	13.4	25.2	31.6	28.0	20.9	55.8	48.9
Government-sponsored enterprise borrowing	5.3	5.5	12.0	21.4	21.9	21.4	34.8	32.8	53.5	55.0
Federal and federally assisted borrowing	64.8	117.4	79.0	93.9	80.7	123.5	142.1	199.7	325.3	297.9
Total funds raised in U.S. credit markets 2/	177.9	307.9	308.3	383.4	426.4	366.4	427.2	408.7	N/A	N/A
Participation ratio (%)	36.4	38.1	25.6	24.5	18.9	33.7	33.3	48.9	N/A	N/A

1/ Direct loans, guaranteed loans and Government-sponsored enterprises are measured on a net basis (disbursements less repayments).
2/ Actuals from Federal Reserve Board Flow of Funds Accounts. Nonfinancial sectors, excluding equities.

OFF-BUDGET OUTLAYS
(in billions of dollars)

Fiscal Period	FFB	Other	FFB as a Percent of Total
1974.....	$ 0.1	$ 1.3	7%
1975.....	6.4	1.7	79
1976.....	5.9	1.4	80
TQ.....	2.6	-0.8	144
1977.....	8.2	0.5	94
1978.....	10.6	-0.3	102
1979.....	13.2	-0.7	106
1980.....	14.5	-0.3	102
1981.....	21.0	-*	100
1982.....	14.1	3.2	82
1983 est.	13.9	2.4	85
1984 est.	11.3	2.7	80

As the preceding table shows, FFB outlays comprise most of the off-budget outlays of the Federal Government. The problem of off-budget outlays is thus primarily a problem of the budgetary treatment of programs financed by the FFB. Under our July 1983 budget estimates, we project FFB outlays to decline significantly over the next several years primarily due to reduced program levels by the Farmers Home Administration:

ESTIMATED FFB OUTLAYS
(in billions of dollars)

1983.....	$13.9
1984.....	11.3
1985.....	10.4
1986.....	9.0

Achieving these reductions in off-budget outlays will be difficult. One maior reason is that, as discussed above, the off-budget FFB outlays are not subject to the same budgetary review and control they would be if they were counted in the budget totals and charged to the agencies that are responsible for them.

The magnitude of off-budget FFB activity can be seen in terms of its asset holdings as well as its outlays. The assets held by the FFB at the end of June 1983 are summarized below:

FFB ASSET HOLDINGS
(in billions of dollars)

Agency debt	
On-budget agencies	$27.4
Off-budget entities	1.3
Subtotal	28.7
Loan assets purchased from agencies.	58.6
Loans directly made to the public...	44.7
Subtotal	103.3
Total	132.0

As of the end of June 1983, the FFB had financed agency operations amounting to a net total of $132.0 billion. These are the cumulative results, from 1974 to the present, of FFB purchasing agency debt securities, buying agency loan assets, and making agency-guaranteed direct loans to the public. The FFB's purchases of agency debt are properly accounted for now. An agency incurs outlays when it spends the proceeds of its borrowing, not when it

borrows. However, the $103 billion of loan asset purchases and direct loans made to the public constitute Federal outlays that were not recorded in the budget because the FFB is itself off-budget.

This $103 billion of off-budget outlays did, of course, have to be financed by Treasury borrowing, just as did the budget deficit. It therefore added $103 billion to the debt borrowed from the public and to the amount of debt outstanding that is subject to the statutory limit. Since agency debt is generally not subject to the statutory limit, the replacement of agency debt in the market by Treasury debt also added to the total amount of debt subject to limit. Thus, because of the FFB, these agency issues and guarantees are now properly reflected in the total public debt and we support the objectives of now taking the next step and including these activities in the budget as well.

The FFB's financing of various programs is concentrated in a few agencies. As shown below, in 1982 the Farmers Home Administration and the Rural Electrification Administration accounted for more than two thirds of FFB outlays, and the foreign military sales credit program accounted for nearly half of the remainder.

MAJOR USERS OF THE FFB
(in billions of dollars)

	1982
Farmers Home Administration.....	$4.9
Rural Electrification Administration....	4.5
Foreign military sales credit.....	2.3
Student Loan Marketing Association.....	0.7
Low-rent public housing.....	0.7
Other.....	1.0
Total.....	14.1

In the past decade, there has been a rapid expansion of Federal credit activity through on- and off-budget direct loans, guaranteed loans, and Government-sponsored enterprise lending. Federally subsidized credit changes the allocation of credit from what would otherwise be provided in credit markets and causes distortions in resource allocation and the loss of economic efficiency. The costs of such activity must be weighed against the public benefits of credit programs. In order to obtain accurate accounting of the costs of Federal credit programs, we need to include all direct lending in the budget. This step is not only more honest in the sense of being more consistent and uniform, but it also permits more accurate scrutiny of Government lending.

Budget Concepts

The Report of the President's Commission on Budget Concepts of 1967 is the foundation for the unified Federal budget. To gain budgetary control over the receipts and spending of the Government, the budget should include all of the Government's receipt and spending transactions. To do this consistently, cash flows must be measured for all uses. The past use of the FFB is the greatest evasion of the cash flow concept of the unified budget.

The key improvement that we could make in our present budget process is, therefore, to attribute the cash outlays of the FFB to the appropriate agencies and programs in the unified budget. The overall budget totals would then measure more accurately the true size of Government outlays and the Government deficit. Attribution of the FFB's outlays to each responsible agency would

improve control over the allocation of credit resources among different uses, agency-by-agency and function-by-function. Alternative programs cannot be compared with each other unless they are consistently and fully measured. Failure to correct the current treatment of FFB activity will continue the distortions, abuses, and lack of control over Federal lending that have plagued proponents of sound budget management for years.

One way of illustrating the inadequate and arbitrary budget treatment of the existing mixture of on- and off-budget lending is to examine a few large lending programs. The table below shows selected net loan outlays and outstanding direct loans for 1982.

(in billions of dollars)

	Net Loan Outlays	Direct Loans Outstanding	
		Amount	Percentage
CCC fund:			
On-budget	$ 6.3	$12.5	100%
Agricultural credit insurance fund:			
On-budget	-0.2	0.8	3
In FFB (off-budget)	1.1	23.4	97
Rural housing insurance fund:			
On-budget	-0.4	0.4	2
In FFB (off-budget)	2.8	23.9	98
Export-Import Bank:			
On-budget	0.8	16.6	100
Foreign military sales credits:			
On-budget	-0.1	0.3	3
In FFB (off-budget)	2.3	11.4	97
P.L. 480 food aid credits:			
On-budget	0.6	8.3	100

(in billions of dollars)

	Net Loan Outlays		Direct Loans Outstanding	
			Amount	Percentage
REA:				
Off-budget REA	0.1		9.8	33%
In FFB (off-budget)	4.5		19.4	67
Total	$17.8		$126.8	
On-budget	$ 7.0	(39%)	$ 38.9	(31%)
Off-budget	10.8	(61%)	87.9	(69%)

There is no defensible reason for the mixture of on- and off-budget lending transactions illustrated in the table. These inconsistent financing practices have come about because of the efforts of agencies and interest groups to maintain a fiction of low program costs through financing activities off-budget. It is difficult for budgetary control incentives to work effectively in this atmosphere. Through the credit budget process, the Administration is trying to build a more rational system, but as long as off-budget spending is invisible to the unified budget process, it will be considered a "free good" rather than another method of Government allocation of scarce taxpayers' resources.

Some might argue that the remedy to the inconsistent treatment of lending control is to exclude all lending from the unified budget. The Administration disagrees:

-- Federal loans allocate economic resources -- just as do other forms of Federal outlays -- and as such they should be included in the unified budget.

-- All Federal loans involve the use of Federal cash; such cash must come from taxes, the sale of assets, or borrowing from the public. From 1974 to June 1983, the FFB directly accounted for a $103 billion addition to the Federal debt in order to finance loans to support agency programs.

-- Federal loan programs generally have major and varying elements of subsidy that are inseparable from the loans. These subsidy elements are no different from other Federal subsidies that are included as outlays. With the best of will, it would be virtually impossible to measure the subsidies accurately.

-- If Federal lending were excluded from the unified budget, strong incentives would exist to substitute lending for grants or direct purchases. Loans would be perceived as costless to the Government and therefore given more readily, merely to avoid the difficult decisions on resource allocation that are part of the budget process.

I would emphasize, however, that placing FFB outlays on-budget does not solve the problem of credit control nor does it lessen the need for a credit budget. If anything, the credit budget must be strengthened. It is the only mechanism that we have for monitoring all Federal credit activity, loan guarantees as well as direct loans. It measures the total amount of new Federal credit activity, in contrast to the net outlays recorded for on- and off-budget direct loans.

The credit budget is therefore an essential part of our budget process and will remain essential even with all FFB outlays included in the budget and attributed to the programs that are supported by the FFB on their behalf. At the same time that the credit budget is essential, however, it is not sufficient as a control mechanism. It needs to be complemented by the inclusion of all direct lending in the unified budget, so that direct lending can be compared with other types of Federal spending.

Coverage of S. 1679

For all of the above reasons, the Administration supports the basic provisions of S. 1679. There are, however, some essential amendments that we would recommend. As written, S. 1679 states that Federal agencies may not issue, sell, or guarantee obligations "of a type" that were issued, sold, or guaranteed and financed through the FFB during the period beginning October 1, 1981, and ending September 30, 1984, unless those obligations are first offered for sale to the FFB.

We are concerned that such wording would allow new or existing programs, which are financed directly in the investment securities markets or which altered the characteristics of their obligations, to escape the discipline of the budget. We therefore recommend wording that requires agencies to offer for sale to the FFB any obligations of a type normally financed in the investment securities market. This requirement could be waived in those cases where we determined that the obligations (1) were not suitable investments of the FFB because of the credit risks entailed in the obligation or (2) were financed in a manner that is least disruptive of private financial markets and institutions. The Administration, in a separate report, will discuss the debt management implications of the bill and provide specific language to correct the deficiencies of the bill.

Conclusions

S. 1679 would require that all transactions of the Federal Financing Bank be included in the Federal budget and attributed to the agencies that are responsible for them. Such requirements are consistent with the budget concepts and concerns that I have just described. The basic provisions of S. 1679 are important, and we support them. We therefore would welcome the opportunity to work with your Committee on the amendments necessary to achieve the principles of S. 1679 in the most effective way.

26-196 O—83——3

Senator TRIBLE. I thank you very much. I have read your statement twice prior to this hearing. It is well done. I think it presents a very strong case for the action contemplated by this legislation.

Let me ask you, in terms of your oral statement today, to flesh out a point made in your written statement submitted for the record, and that is, why do loans as a conceptual matter belong in the Federal unified budget? You touched on that issue, talked about measuring cash flow. You set forth in your statement on pages 10 and 11 certain public policy reasons.

I would like you to take a few minutes and discuss that for our purposes here today, if you will, because I think that's really the heart of the matter.

Mr. WRIGHT. Certainly, Mr. Chairman. From my point of view, it's very simple. Direct loans basically are a cash outlay by the Federal Government. There is not any difference between them and an S&E account or any other type of direct outlay of the Federal Government.

However, in many cases, for some reason, whether it be politics or the national priorities at the time, we decided that we were going to treat them as if they weren't outlays. And, as you said in your statement introducing the bill, this treatment is inconsistent at best, and dishonest at worst.

And since, if you are going to have a unified budget, and you're going to hold to the principle of a unified budget, then all cash transactions should be included in that budget. And we think that excluding some transactions is a fairly substantial breach of budget discipline. I understand that you're going to have witnesses that are going to come in and say that it's a very small percentage of the total. Mr. Chairman, any percentage of the total is a breach in the discipline of the unified budget, and if that's the case, we should state it. We feel very strongly that this bill represents a way to be able to measure not only the priorities of the Federal Government, but to properly account for them.

Senator TRIBLE. Senator Proxmire?

Senator PROXMIRE. On page 13, Mr. Wright, you say in the second sentence, "We therefore recommend wording that requires agencies to offer for sale to the FFB any obligations of a type normally financed in the investment securities market."

Is it your interpretation that the bill as drafted would permit any new program to go directly to the market without going to the FFB and therefore escape the budget?

Mr. WRIGHT. We are concerned, Senator, that a new program may not be included specifically within S. 1679.

We are also concerned, for example, that an agency would be able to make a slight revision to an existing program or security and thus escape the provisions of S. 1679. Therefore we would like improved language there.

Senator PROXMIRE. Make a slight revision, call it a new program, and thereby escape the inclusion in the budget?

Mr. WRIGHT. Yes. They would only have to change the terms of the security or obligation. For example, they could change the pooling arrangements.

Senator PROXMIRE. Senator Gorton and I tried to deal with that problem in our S. 711.

Could you submit specific legislative language to close that potential loophole?

Mr. WRIGHT. Yes, sir. I would be more than happy to.

[Information not received in time for publication.]

Senator PROXMIRE. Thank you.

Senator TRIBLE. Let me just add, if I might, at this point, that our purpose is to retain the activities now undertaken by the Federal Financing Bank, and not permit agencies to end-run that function. At the same time, precise language is difficult. Wording could well involve picking up activities that are now financed by the private sector. I am not sure that is our objective here, but we want to maintain the discipline of the Federal Financing Bank. We want to make sure those activities are fully reported.

Mr. WRIGHT. Mr. Chairman, I totally agree with you. I think we, as you, have been concerned about picking up inappropriate activities. For example, we have partial guarantees, or activities that are handled most efficiently by the private sector right now. As I said, we are sensitive to that concern, and would be more than happy to work with you on the language.

Senator TRIBLE. Senator Gorton.

Senator GORTON. No questions.

Senator TRIBLE. Senator Hecht.

Senator HECHT. No questions.

Senator TRIBLE. Well, I have a number of questions, Mr. Wright. But their purpose really is to bring out in your testimony today the points you made very persuasively and eloquently in your prepared statement. Since that's part of the record, I will not detain you further, but thank you for being here this morning.

Mr. WRIGHT. Thank you very much, Mr. Chairman.

Senator TRIBLE. Mr. Penner, Rudolf Penner, Director of the Congressional Budget Office.

Director Penner, welcome. To my knowledge, this is the first time you have appeared before the Senate Banking Committee. Whether this is your first or second appearance, you are more than welcome, and we wish you well in your new responsibilities.

STATEMENT OF RUDOLF G. PENNER, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. PENNER. Thank you very much, Mr. Chairman. It is, indeed, my first time before this or any Senate committee as CBO Director.

I am very pleased to appear before this committee to discuss S. 1679, the Honest Budgeting Act of 1983. I strongly support the objectives of this bill.

The current budgetary treatment of the Federai Financing Bank has created two problems not foreseen at the bank's inception: the transfer of on-budget outlays off-budget as a result of the FFB's purchase of loan assets from on-budget agencies, and the conversion of loan guarantees into off-budget direct Government loans. This potentially causes confusion about fiscal policy and may distort the allocation of resources among programs.

The Congressional Budget Office believes that the budgetary treatment of the FFB should be revised to conform more closely to the original intent of the Congress. This could be accomplished by

modifying the budgetary treatment either of programs financed by the FFB—that is, statute by statute—or of the FFB itself. The Honest Budgeting Act of 1983 introduced by Senator Trible takes the latter approach—it amends the budget treatment of the Federal Financing Bank itself.

My statement this morning will reiterate some of the background material presented to this committee by Dr. Rivlin in the spring. I will also discuss how improving the budget treatment of the FFB relates to the broader concerns of the control of Federal credit activities.

BUDGETARY TREATMENT OF FFB FINANCING

The Federal Financing Bank was intended to be a neutral financial intermediary, lowering the agencies' interest costs but not otherwise affecting the Federal budget. The FFB authorization provided that the bank's activities should not affect the budgetary status of agencies selling obligations to the bank and further provided that the receipts and disbursements of the bank should not be included in the unified budget.

The on-budget activity levels of agencies were not expected to be affected by the establishment of the FFB. In fact, however, the budget treatment of loan asset sales and direct loans to guaranteed borrowers financed by the FFB has affected the unified budget. Under current practices, FFB operations contribute to a situation in which the unified budget deficit understates Federal borrowing requirements, and otherwise identical loans appear to have different budgetary costs.

Special provisions of the law require that sales of certificates of beneficial ownership by the Farmers Home Administration and the Rural Electrification Administration be treated as sales of assets rather than as borrowings by these agencies. The significance of these provisions is that asset sales are treated as negative outlays in the originating agency's budget accounts.

Thus, when the Farmers Home Administration makes $1 million in loans and uses them as collateral for selling $1 million in certificates of beneficial ownership to the FFB, the net outlays for the Farmers Home Administration are zero in the unified budget. The lending activity is recorded as budget authority and outlays of off-budget Federal entities.

In 1982, the sale of certificates of beneficial ownership to the FFB by the Farmers Home Administration reduced on-budget outlays by 70 percent for rural housing, 44 percent for agricultural credit, and 73 percent for rural development.

Similarly, the off-budget Rural Electric and Telephone Revolving Fund shifted all of its direct loans to the FFB, understating its lending by $500 million for 1982.

The budgetary treatment of loan asset sales introduces inconsistency into the budget's consideration for different lending programs. The Farmers Home Administration budget, the agriculture appropriation bill, and related budget functions are all understated in the unified budget. This understatement potentially affects the funding level for these programs.

In my view, almost all federally guaranteed loans should require private participation, either through shared risk or services to the borrower. In the absence of this partnership, guaranteed loans are virtually the same as direct Federal loans. When financed by the FFB, guaranteed loans are converted to direct loans, both guaranteed and financed by the Treasury.

The FFB is authorized to lend directly to borrowers whose loan notes carry a full guarantee of repayment by a Federal agency. The agencies make guarantee commitments to qualified borrowers and then arrange the sale of guaranteed notes to the FFB. The FFB disburses funds raised through the Treasury to the borrowers, thus converting loan guarantees authorized by the Congress into direct loans. The conversion of loan guarantees into direct loans bypasses the constraints established by the Congressional Budget Act of 1974. The Budget Act specifically excludes guaranteed loans from the definition of budget authority. Direct loans, in contrast, require budget authority and are included in the targets and ceilings enacted in the budget resolutions.

When guaranteed loans are converted to direct loans, agencies increase their direct lending without having to request additional budget authority. The largest programs are the Rural Electric and Telephone Revolving Fund, which effectively increased its direct loans from the $1.1 billion authorized to $5.8 billion extended in 1982, and the foreign military sales credit program, which increased its direct loans from $0.4 billion to $3.5 billion in 1982. These direct loans are accounted for in the off-budget FFB, not in the on-budget agency of origination.

To the extent that financing by the FFB enables agencies to lend more money, it affects the allocation of Federal resources. It also increases direct Federal borrowing requirements and the gap between the unified budget deficit and total Federal borrowing.

HONEST BUDGETING ACT OF 1983

Senator Trible has introduced legislation to correct the problems presented by the budgetary treatment of the FFB by amending the Federal Financing Bank Act. The Honest Budgeting Act of 1983 would require the transactions of the FFB to be reflected in the unified budget. The Federal budget would, therefore, more accurately reflect the fiscal operations of the Federal Government. The bill would require the transactions of the FFB to be recorded in the originating agencies' budgets, thereby insuring that all agency transactions would be taken into consideration as budget resources were allocated. Budget authority would have to be appropriated for any agency-guaranteed loan that was financed by the FFB.

In order to insure that agencies could not bypass the FFB and return to the securities market, the Honest Budgeting Act would require that all activities financed through the bank prior to the effective date would remain in the bank thereafter. Thus, when the new accounting provisions took effect, these activities would be fully and correctly recorded in the budget.

We understand that the intent of the bill is to freeze current practice with respect to programs now financed through the FFB and to correct their budget treatment. Thus, all guarantees cur-

rently financed as direct loans by the FFB would continue to be financed by the FFB but would be correctly recorded as direct loans. Additional guarantee programs could be financed by the FFB if they were appropriately recorded as direct loans of the originating agencies. Assuming this interpretation is correct, I believe that this is the right approach.

As noted previously, I would prefer to see most guaranteed loans have significant private sector involvement, and as a result, they would not qualify for FFB financing.

Had the Honest Budgeting Act been in place for fiscal year 1982, total unified budget outlays would have increased by $14 billion, or 2 percent. Federal borrowing requirements would have been unchanged. Two budget functions would have been greatly increased: the energy function by 111 percent and the commerce and housing function by 74 percent. The budgets of individual agencies would have been increased even more dramatically. Farmers Home Administration outlays would have increased from $3 billion to $8 billion. Outlays for the military sales program would have increased by 460 percent.

To the individual agencies and borrowers that have benefited from the present budgetary treatment of the FFB, the Honest Budgeting Act no doubt presents some concerns. The budget authority and outlays they have previously shifted to the FFB would henceforth be shown in their budgets.

But the effects should not be overstated.

First, the standard budget convention is to adjust all historical data to reflect subsequent changes in budget structure. There would be no jump in year-to-year agency budget authority and outlays upon implementation of the Honest Budgeting Act.

Second, the program levels of almost all of the large credit programs financed through the FFB are clearly controlled through the appropriations process. As part of the credit budget, the Appropriations Committees have set limits on new direct loan obligations and loan guarantee commitments for all but three of the programs financed through the FFB.

Correcting the budgetary treatment of the FFB will improve the unified budget. It will make the unified budget more comprehensive and improve accountability by recording transactions in their appropriate places. The unified budget will become a better measure of the cash flow of the Federal Government, and of Federal borrowing requirements. Improving the unified budget treatment of lending is, however, only a partial solution to the budget treatment of credit programs.

The unified budget is an inadequate device to control Federal credit activities in several respects; first, it understates program levels; second, it overstates the long-term costs of credit programs, since most loans will ultimately be repaid; and, finally, it does not present clearly the long-run costs arising from subsidies and loan defaults.

The unified budget understates program levels for direct loans by counting only net lending; that is, new loans less repayments. The costs of guaranteed loans are recorded in the budget only when borrowers default. To some extent, this shortcoming is addressed in the credit budget which, the Budget Committees have implemented

on an experimental basis by establishing nonbinding limits on new direct loan obligations and loan guarantee commitments. The credit budget will still be necessary even after the FFB is reformed. I believe that credit budget procedures should be fully incorporated into the Congressional Budget Act.

Neither the unified budget nor the credit budget, however, accurately describes the relative cost to the taxpayer of spending, lending, and guarantees. Direct Federal spending for purchases, grants, or income transfers has a different cost from direct loans of Federal funds, most of which will be repaid, and from Federal guarantees of private transactions, which are contingent costs to taxpayers. A dollar of income transfers is not equal to a dollar of direct loans or a dollar of guaranteed private borrowing in the amount of income generated or in long-term Federal financing requirements.

Since these are important cost criteria for deciding how best to deliver a Government service, the absence of a common metric for these different programs can, and probably has, distorted choice. CBO has a study in progress on the relationship between spending and lending.

In closing, I see three changes needed to improve the budget treatment of credit programs: recording agency activities financed by the FFB in the originating agencies' budgets, implementation of a congressional credit budget, and further study of the relationship between spending and lending programs.

We look forward to working with you on these issues.

[The complete statement follows:]

Statement of

Rudolph G. Penner
Director
Congressional Budget Office

Mr. Chairman, I am pleased to appear before this Committee to discuss S. 1679, the Honest Budgeting Act of 1983. I strongly support the objectives of this bill.

The current budgetary treatment of the Federal Financing Bank (FFB) has created two problems not foreseen at the bank's inception: the transfer of on-budget outlays off budget as a result of the FFB's purchase of loan assets from on-budget agencies, and the conversion of loan guarantees into off-budget direct government loans. This potentially causes confusion about fiscal policy and may distort the allocation of resources among programs.

The Congressional Budget Office (CBO) believes that the budgetary treatment of the FFB should be revised to conform more closely to the original intent of the Congress. This could be accomplished by modifying the budgetary treatment either of programs financed by the FFB or of the FFB itself. The Honest Budgeting Act of 1983 introduced by Senator Trible takes the latter approach--it amends the budget treatment of the Federal Financing Bank itself.

My statement this morning will reiterate some of the background material presented to this Committee by Dr. Rivlin in the spring. I will also discuss how improving the budget treatment of the FFB relates to the broader concerns of the control of federal credit activities.

FEDERAL FINANCING BANK OPERATIONS

Since 1974 the FFB has become an important source of financing for loans directly issued or guaranteed by federal agencies. The FFB portfolio has grown rapidly and steadily since its inception. Its outstanding holdings totaled $124.3 billion in fiscal year 1982 and, if current policy is continued, would exceed $210 billion by 1988.

The FFB engages in three types of activities: purchasing loan assets (certificates of beneficial ownership--CBOs) from agencies, making direct loans to borrowers holding agency guarantees, and purchasing agency debt. The largest activity is purchase of loan assets, which accounted for 46 percent of the FFB's total holdings at the end of fiscal year 1982. The FFB has become the primary buyer of loan assets sold by federal agencies. In 1975, its first full year of operation, the FFB purchased 63.8 percent of all loan assets offered for sale by federal agencies. By 1982 the FFB's share had increased to 86 percent, or $12.6 billion of the $14.8 billion of assets offered for sale. The Farmers Home Administration (FmHA) has been the principal seller of loan assets to the FFB. As shown in Table 1, FFB holdings of Farmers Home Administration certificates at the end of fiscal year 1982 totaled $53.7 billion, or 94 percent of the bank's loan asset holdings.

The second largest category of FFB activity is direct loans to guaranteed borrowers, which represent 32 percent of the bank's assets.

TABLE 1. FFB OUTSTANDING HOLDINGS BY TYPE OF ACTIVITY, FISCAL YEARS 1980-1982 (In billions of dollars)

Type of Activity	1980	1981	1982
Loan Assets			
Agricultural Credit Insurance (FmHA)	37.9 a/	22.4	23.4
Rural Housing Insurance (FmHA)	---	21.1	23.9
Rural Development Insurance (FmHA)	---	5.3	6.4
Rural Electrification Administration	1.9	2.6	3.1
Other	0.6	0.4	0.4
Subtotal	40.4	51.8	57.2
Direct Loans to Guaranteed Borrowers			
Foreign Military Sales	7.2	9.1	11.4
Rural Electrification Administration	8.4	12.3	16.3
Student Loan Marketing Association	2.3	4.3	5.0
Low-Rent Public Housing	0.1	0.9	1.6
Rail programs	1.1	1.5	1.1
Small Business Administration	0.5	0.6	0.7
Seven States Energy Corporation	0.7	0.9	1.3
Other	1.2	1.5	1.9
Subtotal	21.5	31.1	39.3
Agency Debt			
Export-Import Bank	10.1	12.4	14.0
Tennessee Valley Authority	8.9	10.9	12.3
Postal Service	1.5	1.3	1.2
Other	0.6	0.3	0.3
Subtotal	21.1	24.9	27.8
Total	83.0	107.8	124.3

SOURCE: Budget of the U.S. Government, Fiscal Years 1982, 1983, and 1984, Special Analyses.

a. Includes activities of the Rural Development Insurance Fund and Rural Housing Insurance Fund.

Instead of raising funds in the securities market, a borrower with a guarantee from a federal agency may have the FFB purchase the entire security issue. Thus, in effect, the FFB makes a direct loan to that borrower. In terms of dollar volume, the two largest categories of borrowers have been rural electric cooperatives, under guarantees by the Rural Electrification Administration, and foreign purchasers of U.S.-made military equipment, under guarantees by the Department of Defense. These two categories accounted for $27.7 billion of the FFB direct loans outstanding at the end of 1982, or 70 percent of the total.

The remaining 22 percent of the FFB portfolio consists of holdings of agency debt. Since its inception in 1974, the FFB has been the sole financing agent for nearly all new issues of agency debt. At the close of fiscal year 1982, its holding of agency debt was $27.8 billion. The main debt issues held are those of the Export-Import bank and the Tennessee Valley Authority. In recent years, the U.S. Railway Association and the Postal Service have both redeemed some of their debt held by the FFB.

BUDGETARY TREATMENT OF FFB FINANCING

The Federal Financing Bank was intended to be a neutral financial intermediary, lowering the agencies' interest costs but not otherwise

affecting the federal budget. The FFB authorization provided that the bank's activities should not affect the budgetary status of agencies selling obligations to the bank, and further provided that the receipts and disbursements of the bank should not be included in the unified budget. The on-budget activity levels of agencies were not expected to be affected by the establishment of the FFB. In fact, however, the budget treatment of loan asset sales and direct loans to guaranteed borrowers financed by the FFB has affected the unified budget. Under current practices, FFB operations contribute to a situation in which the unified budget deficit understates federal borrowing requirements and otherwise identical loans appear to have different budgetary costs.

Shifting of On-Budget Outlays Off Budget Through Loan Asset Sales

Special provisions of law require that sales of certificates of beneficial ownership by the Farmers Home Administration and the Rural Electrification Administration (REA) be treated as sales of assets rather than as borrowing by these agencies. The significance of these provisions is that asset sales are treated as negative outlays in the originating agency's budget accounts. Thus, when the Farmers Home Administration makes $1 million in loans and uses them as collateral for selling $1 million in certificates of beneficial ownership to the FFB, the net outlays for the Farmers Home

Administration are zero in the unified budget. 1/ The lending activity is recorded as budget authority and outlays of "off-budget federal entities."

In 1982 the sale of certificates of beneficial ownership to the FFB by the Farmers Home Administration reduced on-budget outlays by 70 percent for rural housing, 44 percent for agricultural credit, and 73 percent for rural development (see Table 2). Similarly, the off-budget Rural Electric and Telephone Revolving Fund shifted all of its direct loans to the FFB, understating its lending by $500 million for 1982.

The budgetary treatment of loan asset sales introduces inconsistency into the budget's consideration for different lending programs. The Farmers Home Administration budget, the Agriculture appropriation bill, and related budget functions are all understated in the unified budget. This understatement potentially affects the funding level for these programs.

---

1. Sales of loan assets other than certificates of beneficial ownership to the public by federal agencies convey ownership and servicing responsibility to the purchaser. When a certificate is sold to the FFB, however, the originating agency retains risk of default and servicing. The case can be made that the certificate transaction is borrowing rather than an asset sale.

TABLE 2. COMPOSITION OF OUTLAYS FOR LOAN PROGRAMS FINANCED BY THE FFB, FISCAL YEAR 1982 (In billions of dollars)

	Agency Outlays	FFB Outlays	Total	FFB Outlays as Percent of Total
Shifting of On-Budget Outlays Off Budget Through Loan Asset Sales				
Farmers Home Administration				
Agricultural Credit Insurance	1.4	1.1	2.5	44
Rural Housing Insurance	1.2	2.8	4.0	70
Rural Development Insurance	0.4	1.1	1.5	73
Rural Electrification Admin.	0.5 a/	0.5	0.5	100
FFB Conversion of Guaranteed Loans to Direct Loans				
Rural Electrification Admin.	---	4.0	4.0	100
Foreign Military Sales	---	2.3	2.3	100
Tennessee Valley Authority	---	0.3	0.3	100
Small Business Administration	---	0.1	0.1	100
Student Loan Marketing Assn.	---	0.7	0.7	100
Alternative fuels production	---	0.3	0.3	100
Low-rent public housing	---	0.7	0.7	100
Other	---	0.2	0.2	100
Total	3.5	14.1	17.1	82

SOURCE: Budget of the United States Government, Fiscal Year 1984, Special Analyses.

a/ The authorization for the REA excludes it from the budget. It is in every other respect comparable to on-budget lending programs.

FFB Conversion of Guaranteed Loans to Direct Loans

In my view, almost all federally guaranteed loans should require private participation--either through shared risk or services to the borrower. In the absence of this partnership, guaranteed loans are virtually the same as direct federal loans. When financed by the FFB, guaranteed loans are converted to direct loans, both guaranteed and financed by the Treasury.

The FFB is authorized to lend directly to borrowers whose loan notes carry a full guarantee of repayment by a federal agency. The agencies make guarantee commitments to qualified borrowers and then arrange the sale of guaranteed notes to the FFB. The FFB disburses funds raised through the Treasury to the borrowers, thus converting loan guarantees authorized by the Congress into direct loans. The conversion of loan guarantees into direct loans bypasses the constraints established by the Congressional Budget Act of 1974. The Budget Act specifically excludes guaranteed loans from the definition of budget authority. Direct loans, in contrast, require budget authority and are included in the targets and ceilings enacted in the budget resolutions.

When guaranteed loans are converted to direct loans, agencies increase their direct lending without having to request additional budget authority. The largest programs are the Rural Electric and Telephone

Revolving Fund, which effectively increased its direct loans from the $1.1 billion authorized to $5.8 billion extended in 1982, and the foreign military sales credit program, which increased its direct loans from $0.4 billion to $3.5 billion in 1982. These direct loans are accounted for in the off-budget FFB, not in the on-budget agency of origination.

To the extent that financing by the FFB enables agencies to lend more money, it affects the allocation of federal resources. It also increases direct federal borrowing requirements and the gap between the unified budget deficit and total federal borrowing.

Purchases of Agency Debt

The final form of financial transaction engaged in by the FFB is its purchase of agency debt, such as notes issued by the Tennessee Valley Authority. When an agency sells notes to the FFB, it obtains favorable interest rates. The outlays that the agency makes are recorded in the agency's budget (not the FFB's), and the full impact on government borrowing needs is recorded in the unified budget. Since this activity of the FFB performs a useful service and causes no budget distortions, it should be allowed to continue even if reforms are undertaken to correct the accounting of other FFB activities.

WHY THE BUDGET DEFICIT UNDERSTATES TOTAL FEDERAL BORROWING

The unified budget deficit--the difference between revenues and on-budget outlays--is featured in the President's budget, the Congressional budget resolutions, and most discussions of fiscal policy. But the total borrowing requirements of the federal government, which determine the government's impact on financial markets, also include off-budget outlays. Moreover, the debt ceiling has to be raised to cover financing requirements that result from off-budget as well as on-budget deficits. Unnecessary confusion is added to the budget debate by the fact that the unified deficit understates the government's financing requirements.

Most of the off-budget deficit is accounted for by the transactions of the FFB. (The off-budget deficit also includes the net outlays of the U.S. Postal Service, the Rural Telephone Bank, and the Strategic Petroleum Reserve.) Table 3 shows the extent to which the off-budget accounts understated the total deficit from 1974 to 1983. Because of the FFB, the unified budget deficit understated total deficit spending by nearly one-third in 1979. Since that year, the unified budget deficit has grown so rapidly that it has outpaced the off-budget deficit.

TABLE 3. UNDERSTATEMENT OF THE BUDGET DEFICIT, FISCAL YEARS 1974-1983 (In billions of dollars)

Fiscal Year	Unified Budget Deficit	FFB Outlays	Other Off-Budget Outlays a/	Total Federal Deficit	Unified Budget Deficit as a Percent of Total Deficit
1974	4.7	0.1	1.3	6.1	77.0
1975	45.2	6.1	2.0	53.3	84.8
1976	66.4	6.1	1.2	73.7	90.0
TQ	13.0	2.6	-0.9	14.7	88.4
1977	44.9	8.1	0.6	53.6	83.7
1978	48.8	10.7	-0.3	59.2	82.4
1979	27.7	13.3	-0.8	40.2	68.9
1980	59.6	14.4	-0.2	73.8	80.8
1981	57.9	21.0	---	78.9	73.4
1982	110.6	14.2	3.1	127.9	86.5
1983	207.0	14.2	2.3	223.0	92.8

SOURCES: Fiscal years 1974-1982 data, Budget of the United States Government 1976-1982; fiscal year 1983 data, Congressional Budget Office, The Economic and Budget Outlook: An Update (August 1983).

a. Includes outlays of the U.S. Postal Service, Rural Telephone Bank, Regional Rail program, and the Strategic Petroleum Reserve.

POSSIBLE SOLUTIONS

There are several alternative approaches to correcting the budget presentation of the FFB. 2/ The budgetary problems raised by the FFB are

---

2. See Congressional Budget Office, The Federal Financing Bank and the Budgetary Treatment of Federal Credit Activities (January 1982).

attributable to the budgetary treatment of the transactions it finances: purchases of loan assets and the making of direct loans to guaranteed borrowers. The problems can be solved by changing the budgetary treatment either of those transactions or of the FFB itself.

Simply putting the FFB on budget would make the unified deficit a better indicator of federal financing needs. But it would still leave the activity levels in the lending and guaranteeing agencies understated. Thus, unless the budgetary treatment of FFB loan asset purchases and direct loans is addressed, distortion in the budget will persist.

Honest Budgeting Act of 1983

Senator Trible has introduced legislation to correct the problems presented by the budgetary treatment of the FFB by amending the Federal Financing Bank Act. The Honest Budgeting Act of 1983 (S. 1679) would require the transactions of the FFB to be reflected in the unified budget. The federal budget would, therefore, more accurately reflect the fiscal operations of the federal government. The bill would require the transactions of the FFB to be recorded in the originating agencies' budgets, thereby ensuring that all agency transactions would be taken into consideration as budget resources were allocated. Budget authority would have to be appropriated for any agency-guaranteed loan that was financed by the FFB.

In order to ensure that agencies could not bypass the FFB and return to the securities markets, the Honest Budgeting Act would require that all activities financed through the bank prior to the effective date would remain in the bank thereafter. Thus, when the new accounting provisions took effect, these activities would be fully and correctly recorded in the budget.

We understand that the intent of the bill is to freeze current practice with respect to programs now financed through the FFB and to correct their budget treatment. Thus, all guarantees currently financed as direct loans by the FFB would continue to be financed by the FFB but would be correctly recorded as direct loans. Additional guarantee programs could be financed by the FFB if they were appropriately recorded as direct loans of the originating agencies. Assuming this interpretation is correct, I believe that this is the right approach. As noted previously, I would prefer to see most guaranteed loans have significant private sector involvement, and as a result, they would not qualify for FFB financing.

Had the Honest Budgeting Act been in place for fiscal year 1982, total unified budget outlays would have increased by $14 billion, or 2 percent. Federal borrowing requirements would have been unchanged. Two budget functions would have been greatly increased: the energy function by 111 percent, and the commerce and housing function by 74 percent (see Table 4).

The budgets of individual agencies would have been increased even more dramatically. Farmers Home Administration outlays would have increased from $3 billion to $8 billion. Outlays for the foreign military sales program would have increased by 460 percent (see Table 5).

TABLE 4. IMPACT OF SHIFTING FFB OUTLAYS ON BUDGET, BY BUDGET FUNCTION, FISCAL YEAR 1982 (In billions of dollars)

Budget Function	On-Budget Outlays	FFB Outlays	Total	Percentage Increase From Shifting FFB Outlays On Budget
International Affairs	10.0	2.3	12.3	23
Energy	4.7	5.2	9.9	111
Agriculture	14.9	1.1	16.0	7
Commerce and Housing	3.9	2.9	6.8	74
Community and Regional Development	7.2	1.1	8.3	15
Other	687.7	1.5	689.2	0
Total	728.4	14.1	742.5	2

SOURCE: Budget of the United States Government, Fiscal Year 1984, Table 14.

To the individual agencies and borrowers that have benefited from the present budgetary treatment of the FFB, the Honest Budgeting Act no doubt presents some concerns. The budget authority and outlays they have previously shifted to the FFB would henceforth be shown in their budgets.

TABLE 5. IMPACT OF SHIFTING FFB OUTLAYS ON BUDGET, BY AGENCY AND PROGRAM, FISCAL YEAR 1982 (In billions of dollars)

Agency/Program	On-Budget Outlays	FFB Outlays	Total	Percentage Increase From Shifting FFB Outlays On Budget
Farmers Home Administration				
Agricultural Credit Insurance	1.4	1.1	2.5	79
Rural Housing Insurance	1.2	2.8	4.0	233
Rural Development Insurance	0.4	1.1	1.5	275
Rural Electrification Admin.	---	4.5	4.5	N/A
Foreign Military Sales	0.5	2.3	2.8	460
Tennessee Valley Authority	1.5	0.3	1.8	20
Small Business Administration	0.6	0.1	0.7	17
Other	11.1	1.9	13.0	17
Total	16.7	14.1	30.8	84

SOURCE: Budget of the United States Government, Fiscal Year 1984, Budget Accounts Listing.

But the effects should not be overstated. First, the standard budget convention is to adjust all historical data to reflect subsequent changes in budget structure. There would be no jump in year-to-year agency budget authority and outlays upon implementation of the Honest Budgeting Act. Second, the program levels of almost all of the large credit programs financed through the FFB are already controlled through the appropriations process. As part of the credit budget, the Appropriations Committees have

set limits on new direct loan obligations and loan guarantee commitments for all but three of the programs financed through the FFB (see Table 6).

CORRECTING FFB ACCOUNTING--A PARTIAL SOLUTION

Correcting the budgetary treatment of the FFB will improve the unified budget. It will make the unified budget more comprehensive and improve accountability by recording transactions in their appropriate places. The unified budget will become a better measure of the cash flow of the federal government, and of federal borrowing requirements. Improving the unified budget treatment of lending is, however, only a partial solution to the budget treatment of credit programs.

The unified budget is an inadequate device to control federal credit activities in several respects: first, it understates program levels; second, it overstates the long-term costs of credit programs since most loans will ultimately be repaid; and finally, it does not present clearly the long-run costs arising from subsidies and loan defaults.

The unified budget understates program levels for direct federal loans by counting only net lending--that is, new loans less repayments. The costs of guaranteed loans are recorded in the budget only when the borrowers default. To some extent, this shortcoming is addressed by the credit budget,

TABLE 6. SOURCE OF PROGRAM LEVELS FOR AGENCY LOAN PROGRAMS FINANCED THROUGH THE FFB (In millions of dollars)

	Authorizations		Appropriations a/	
	1982	1983	1982	1983
Direct Loan Obligations				
Farmers Home Administration				
Agricultural Credit Insurance	---	---	2,129	2,349
Rural Housing Insurance	---	---	3,725	3,314
Rural Development Insurance	---	---	505	730
Rural Electrification Admin.	---	---	1,425	1,425
Health Maintenance Organizations	---	---	76	24
Subtotal	---	---	7,860	7,842
Guaranteed Loan Commitments				
Foreign Military Sales	---	---	3,083	3,931
Rural Electrification Admin.	---	---	6,400	4,745
Rail programs	---	---	100	100
TVA Seven States b/	4,513	5,641	---	---
NASA satellite leases	146	205	---	---
Small Business Administration-Small Business Investment Corporations	215	510	---	---
Student Loan Marketing Assn.	700	---	---	---
Community development grants	---	---	225	225
Other	---	---	25	---
Subtotal	5,574	6,356	9,833	9,001

SOURCE: Congressional Budget Office, An Analysis of the President's Credit Budget for Fiscal Year 1984 (March 1983).

a/ All programs limited by appropriation also were authorized.

b/ The current budget treatment of the Tennessee Valley Authority guarantees overstates program levels because it records refinancing of short-term debt as new loans. The 1985 budget will remove refinancing from the totals. CBO estimates that new loans for 1983 will be $195 million in contrast to the $5.6 billion shown.

which the Budget Committee have implemented on an experimental basis by establishing nonbinding limits on new direct loan obligations and loan guarantee commitments. The credit budget will still be necessary even after the FFB is reformed. I believe that credit budget procedures should be fully incorporated into the Congressional Budget Act.

Neither the unified budget nor the credit budget, however, accurately describes the relative cost to the taxpayer of spending, lending, and guarantees. Direct federal spending for purchases, grants, or income transfers has a different cost from direct loans of federal funds, most of which will be repaid, and from federal guarantees of private transactions, which are contingent costs to taxpayers. A dollar of income transfers is not equal to a dollar of direct loans or a dollar of guaranteed private borrowing in the amount of income generated or in long-term federal financing requirements. Since these are important cost criteria for deciding how best to deliver a government service, the absence of a common metric for these different programs can--and probably has--distorted choice. CBO has a study in progress on the relationship between spending and lending.

In closing, I see three changes as needed to improve the budget treatment of credit programs: recording agency activities financed by the FFB in the originating agencies' budgets, implementation of a Congressional credit budget, and further study of the relationship between spending and lending programs. We look forward to working with you on these issues.

Senator TRIBLE. Thank you for your statement.

DIRECT LOANS SHOULD APPEAR IN A UNIFIED BUDGET

Your statement, I think, is especially helpful in that it presents in a very understandable fashion the activities of the Federal Financing Bank, something that is not easy to do, I might add.

Let me pose the following question. Some argue that Federal loans, such as the loans that we would place on budget through this legislation, should not be in the budget at all as a matter of budget principle.

How would you respond to that assertion?

Mr. PENNER. The main attempt of the unified budget, as I see it, is to show the transactions of the Federal Government on a cash basis so that we know exactly how much financing we will have to do through the sale of ordinary Government debt and through other devices.

Direct loans have to be financed by the issue of Federal debt. In that sense they are exactly like any other outlay of the Government.

It is true that they have different economic effects, and they look differently grossed up than they do on a net basis. The latter problem can be dealt with by having a separate credit budget.

The former problem, of course, is more difficult. There we need a lot more analytic information. There are differences between two different outlays as well. An outlay for a fighter plane is clearly different from an outlay for social security. We don't provide detailed analyses of these differences when we are compiling the unified deficit. We just can't go that far.

But the basic point is that a unified budget deficit is supposed to show us what we have to finance; without direct loans in the deficit number, it doesn't do that.

Senator TRIBLE. I appreciate that statement because I agree that the argument about loans in the unified budget is an argument to provide additional information, supplemental information, on the true cost of those programs rather than excluding them from the unified budget, and I think that is a point that you have made in your response.

Senator Proxmire.

Senator PROXMIRE. Dr. Penner, it is a pleasure to have a chance to meet you. I have read your writings for years. I have admired your judgment. It has been very helpful to me, as I am sure you have been to many Members of the Congress.

Mr. PENNER. Thank you, Senator.

Senator PROXMIRE. From the standpoint of the effect of the economy and the credit markets, do you think there is any appreciable difference between a 100-percent guaranteed obligation sold in the securities market by a Federal agency and the sale of Treasury security?

Mr. PENNER. Very, very little, sir. It is a fact that in the past 100-percent guarantee issues have traded at slightly higher interest rates than ordinary Federal debt.

Senator PROXMIRE. Why shouldn't they have the same budget treatment?

Mr. PENNER. I think 100-percent guarantees sold to the FFB certainly should and, indeed, that is what we are talking about. When the FFB buys them, they become direct loans, and should be included in the unified budget for the purpose of showing how much debt the Federal Government has to raise.

Senator PROXMIRE. My problem is that new guarantee issues in this bill could go directly to the market; they wouldn't be counted in the budget.

Mr. PENNER. Well, as Mr. Wright stated previously, ideally you would like to control 100-percent guarantees by insisting on their sale to the FFB, so that they would, in essence, become direct loans.

Senator PROXMIRE. Do you agree with Mr. Wright that that should be done?

Mr. PENNER. I certainly agree with his intent. I think it will be difficult to accomplish legislatively.

Senator PROXMIRE. It wouldn't be accomplished legislatively because of the political pressures?

Mr. PENNER. Yes, simply because there would be pressure when inventing a new program perhaps to state in the law that they shouldn't be sold to the FFB.

CREDIT PROGRAMS OF FEDERAL GOVERNMENT IGNORED

Senator PROXMIRE. Toward the end of your remarks, you say: "A dollar of income transfers is not equal to a dollar of direct loans or a dollar of guaranteed private borrowing in the amount of income generated or in long-term Federal financing requirements."

Then you say: "CBO has a study in progress on the relationship between spending and lending."

Haven't we been studying this for a long, long time? Is there likely to be any finding that would give us any basis for policy changes?

Mr. PENNER. That is always hard to predict, sir.

Senator PROXMIRE. What would be the possibilities?

Mr. PENNER. I think what we really want to find out in the longer term is how these various direct lending and guarantee programs do affect credit markets in some detail; that is to say, how effective are they at actually transferring real resources to the preferred activity?

While you suggested that maybe this has been studied a lot in the past, I would argue to the contrary, actually. Although there have been a few studies, it is remarkable the extent to which the academic community has ignored the credit programs of the Federal Government, as opposed to numerous studies of tax policy or other spending policy.

I would attribute that lack largely to the fact that credit programs are so well hidden in the budget. Their true importance is not a matter of real public consciousness, even in the academic community.

Senator PROXMIRE. When do you expect to have this study available?

Mr. PENNER. I am not actually sure about it. Do we have a deadline for the study?

VOICE. We haven't.

Mr. PENNER. We will get back to you, Senator, to give you a deadline.

[The report is tentatively scheduled for completion by March 1984.]

Senator PROXMIRE. Is it possible it will be by the time we adjourn in September of 1984?

Mr. PENNER. By September 1984?

Senator PROXMIRE. Yes, sir.

Mr. PENNER. I would think so, sir, yes, sir.

Senator PROXMIRE. Thank you.

Senator TRIBLE. I wonder if you would yield some of your time. I want to follow up a point that Senator Proxmire made.

Senator PROXMIRE. Certainly.

Senator TRIBLE. The point about running all loan guarantees through the FFB.

In your testimony, Dr. Penner, you state:

> We understand the intent of the bill is to freeze current practice with respect to programs now financed through the FFB and to correct their budget treatment. Thus, all guarantees currently financed as direct loans by the FFB would continue to be financed by the FFB but would be recorded as direct loans. Additional guarantee programs could be financed by the FFB if they were appropriately recorded as direct loans of the originating agencies.
>
> Assuming this interpretation is correct, I believe that this is the right approach. As noted previously, I would prefer to see most guaranteed loans have significant private sector involvement, and as a result, they would not qualify for FFB financing.

That statement is consistent with my own thinking. What concerns me here is that if we reach down in the market and we take loan guarantees and we run them through the Federal Financing Bank, we are turning them into Federal loans. I am not sure that is what we want to bring about.

Mr. PENNER. I think what you're getting at, Senator, is that there is quite a difference between 100-percent guaranteed loan, which really has the full faith and credit of the U.S. Government; and a partial guarantee, where the private lender would want to do some underwriting on his own and make his own assessment of the risk. With a 100-percent guaranteed loan, there is really very little concern on the part of the private lender as to making a proper assessment of the risk, and that is left to the issuing agencies to do all of the underwriting.

Senator TRIBLE. Senator Gorton?

Senator GORTON. No questions.

Senator TRIBLE. Senator Hecht.

Senator HECHT. Nothing.

Senator TRIBLE. Dr. Penner, we thank you for being with us today, and we look forward to working with you for some time, all of us.

Mr. PENNER. I look forward to it, also, Mr. Chairman.

Senator TRIBLE. Senator Domenici?

[Response to written questions from the committee follows:]

QUESTIONS SUBMITTED TO THE CONGRESSIONAL BUDGET OFFICE
BY THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
UNITED STATES SENATE

---

1) **You have strongly supported the concept of a comprehensive unified budget. My bill moves us far in that direction. What is lost--by the public, fiscal policy, and the budget process--if the unified budget is not comprehensive?**

The unified budget is the focal point of budget deliberations, assessments of fiscal policy, and public discussions of the budget. An incomplete statement of the scope and cost of government activity in the unified budget adds complexity and creates confusion. Budget deliberations must consider both on- and off-budget numbers. Assessments of fiscal policy must add off-budget activity to on-budget activity in order to consider the full impact of government spending on the economy. Public debate of the budget is made more complex, and public confidence in the ability of the Congress to control the process is weakened.

2) **Compare the budget review process for an on-budget direct loan program, an off-budget FFB-financed direct loan program (such as one financed by a CBO sale), and a loan guarantee program which results in a direct FFB loan off-budget. Are they all subject to the same budget review and scrutiny?**

I will first describe a typical on-budget direct loan, an FFB-financed direct loan, and a guarantee that results in FFB direct loans, and will then review the distinctions in the budget review process for the three types of transactions. Examples of budget transactions are as follows:

- The Export-Import Bank makes direct loans to foreign purchasers of U.S. exports. Direct loan disbursements less any repayments from prior-year loans are recorded as budget authority and outlays of the Export-Import Bank within the unified budget--an on-budget direct loan.

- The Farmers Home Administration (FmHA) makes direct loans to individual farmers to support their farm operations or ownership. Once the loans have been extended, FmHA consolidates a number of individual loans as collateral for a certificate of beneficial ownership (CBO) and sells the CBO to the FFB. The FmHA continues to service the individual loans. The FmHA disbursements have both repayments from prior loans and the

proceeds of the sale of the CBO to the FFB netted in calculating budget authority and outlays for the FmHA accounts. The FFB records off-budget budget authority and outlays for the funds disbursed to purchase the CBO from FmHA. The net effect of this transaction is that FmHA budget authority and outlays are shifted off budget to the FFB.

- The Department of Defense issues guarantees to foreign purchasers of U.S. defense materials and supplies. These guaranteed securities are then sold to the FFB, which disburses the funds to the U.S. producers for the foreign country. Off-budget budget authority and outlays are recorded in the FFB's books for its disbursement. In a guaranteed loan financed by private lenders, no budget authority or outlays would have been recorded unless the borrower defaulted on the loan.

The budget review of these transactions differs from that of comparable activities not funded through the FFB primarily in that the FFB budget authority and outlays are not included in either the budget resolutions or appropriations bills. Program limits on new direct loan obligations and new loan guarantee commitments for most activities financed by the FFB are included in appropriations bills. Budget authority and outlays for the affected budget functions are understated in the budget resolutions and in the totals of the individual appropriations bills. These omissions make the enforcement provisions of the budget process not applicable to these activities.

3a) Does S. 1679 cut any federal program--TVA, REA, FmHA, FMS?

S. 1679 has no impact on actual program levels for any program. It corrects their budget accounting to show budget authority and outlays with the originating agency, rather than the FFB.

3b) S. 1679 makes the judgement that those programs which have been financed through the FFB in the past (as direct loans) should continue to be financed there. But it does not require any other program--present or future--to be financed there. In particular, it allows guarantee programs which have been financed in the private market, as well as any future guarantee program, to be financed in the market. Do you think that is appropriate?

In guarantee programs financed by the FFB, the federal government both guarantees and finances the loan. There is no private

involvement. Such guarantees should be recorded as direct loans consistent with accepted budget concepts.

Programs affected are:

- o Foreign military sales credit guarantees;
- o REA guarantees;
- o TVA Seven States Energy Corporation guarantees;
- o NASA satellite leases; and
- o SBA guaranteed loans to Small Business Investment Corporations and state and local development companies.

There are two distinctions between guarantee programs that have been financed in private markets (and potentially new programs) and those financed by the FFB: the source of funds and the extent of lender participation in the loan. The source of funds is either Treasury or private lenders. Treasury financing represents government funds that could be raised either through taxes or through borrowing. Treasury borrowing is almost equivalent to the sale of government-guaranteed securities in investment securities markets. To a large extent, investors view Treasury debt and government-guaranteed securities as comparable investments. Guaranteed securities do trade at slightly higher rates, however.

The second distinction is the extent of lender participation in the loan. The FFB, as a result of Treasury policy, functions only as a source of funds. It accepts no risk and in no way scrutinizes the loans it finances or provides services to the borrowers. Guarantees financed in private markets involve varying amounts of lender participation from shared risk in the SBA business loan programs to services to borrowers or sophisticated analyses of the costs of loans.

The extent to which guaranteed loans not financed by the FFB are comparable to FFB direct loans is difficult to determine, both in terms of investor response to securities and lender participation. I believe that the appropriate policy should be to increase the distinction between FFB-financed guarantees and transactions in investment securities markets. More lender participation should be required in guaranteed loans. I do not believe that the FFB portfolio should be significantly expanded. In sum, I believe the focus of S. 1679 on loans currently financed by the FFB is appropriate.

4) Among other things, S. 1679 says that those loan guarantee programs which have resulted in direct federal loans from the U.S. Treasury are not loan guarantees, but rather are direct loans, and should be accorded the same budget treatment as on-budget direct loan programs. Would you agree with that? Shouldn't we call a spade a spade, and treat all spades alike?

Yes, loan guarantees guaranteed by the government and financed by the FFB are converted to FFB-financed direct loans. They should receive the same budget treatment as other direct loan programs.

Guaranteed loans were excluded from the Budget Act definition of budget authority, because the guarantee is a contingent liability of the government--involving government expenditure only in case of default. No federal funds are involved. Loan guarantees financed by private institutions and guaranteed by the government should not be treated as direct loans.

5a) Some would argue that federal loan programs--such as the ones brought into the unified budget by this bill--should not be in the unified budget, as a matter of budget principle. How would you respond to this?

The unified budget was designed to reflect the cash flow of the federal government. An accurate picture of the receipts and disbursements for any given year must include outlays for direct loans, even though they will eventually be repaid. The argument that outlays for loans are overstated in the budget in the year they are made because repayments of principal and interest do not affect cash flow until future years does not adequately consider the cash nature of the budget.

While it is true that the budget overstates the cost of loan programs because of repayments, it does not clearly present the true costs of the loans that arise from the subsidy and default costs of new loans extended. These costs occur over the life of the loans, but are incurred at the time the loans are obligated. Better analysis of these costs is needed, and the budget documents should be revised to better present these costs.

5b) Following up, some have suggested that loan programs should not be included in the unified budget because that would make them appear more expensive than they really are. Isn't that really an argument for providing supplementary information on the true cost of such

programs, rather than excluding them from the unified budget--which would make them appear to have zero cost?

The argument that direct loans are overstated in the unified budget because outlays occur in the budget year and repayments in the outyears does nothing to change the need for an accurate reflection of the cash flow of the government. Loan programs must be included in the unified budget so that all outlays can be totaled in one place. Additional analysis and cost information would further clarify the outlays necessary to continue these programs. Excluding them from the unified budget would distort the reflection.

5c) **What rationale can there be for including some loan programs in the unified budget, but not others?**

There is no acceptable rationale for excluding any direct loans, including loan guarantees converted to FFB-financed direct loans, from the unified budget. Guarantees of loans made by private lending institutions should not be included until such time as the government must repay lenders for defaults.

5d) **As a practical matter, isn't the argument that the unified budget "discriminates against" direct loan programs (by making them seem too expensive) weakened substantially by the fact that many loan programs are on a revolving fund basis--and only their net outlays would be recorded in the unified budget anyway? (Even with S. 1679)**

The unified budget includes new direct loans net of repayments on existing loans. The credit budget records the volume of new loans. With the correct cash flow recorded in the unified budget, and the correct program levels recorded in the credit budget, present value analysis is required to discern the remaining costs--that is, the value of interest subsidies--of this type of federal assistance.

6) **I'd like to pick up on several of your observations. On page __ of your testimony, you have two very striking charts. They show the effect of the present arbitrary budget treatment of direct loans by budget function and by federal agency.**

When off-budget outlays are factored into the picture, the federal commitment in just a few budget functions jumps. And the same is true by agency--just a few agencies' budget are revealed to be much larger than they seem to be.

In view of the story told by those charts, isn't there a very substantial likelihood that the budget process, which relies on incorrect information today, is being badly skewed? Isn't it very likely that Congress --if it had the information provided by the accounting provisions in my bill--would allocate its resources very differently? Isn't it probable that we are making suboptimal budget choices by having this incomplete information today?

The allocation among budget functions will clearly change once the off-budget outlays are shown in the originating accounts, as will the allocation among agencies. It is not clear, however, that the corrections in budget numbers will lead to real changes in priorities.

Program levels for most programs financed by the FFB are currently set in appropriations. The Congress has, therefore, considered the funding levels for these activities. Standard budget practice will require historical data to be revised to new practice. The FFB will be shown on-budget for the budget year, current year, and prior year, and there will be no major jumps in funding levels that appear as a result of the change.

When the fact that the functions most affected (Energy, Commerce and Housing) are relatively small functions is considered in conjunction with historical Congressional support for these activities and the budgeting conventions that will apply to the change, I would not foresee a significant impact of this change on the allocation of federal resources.

7a) **On page _ of your testimony, you mentioned that FFB was intended to be a <u>neutral</u> financing agency--it was <u>not intended</u> to change the budget status of programs. Isn't it true, however, that when a federal agency guarantees a loan, but then has the borrower turn to the FFB for a direct, off-budget loan, the FFB's neutral purpose is violated. Doesn't this practice actually allow a federal agency to make loans in excess of the budget authority now allotted to it?**

Yes it does. Loan guarantees do not require budget authority but direct loans do. FFB direct loans are financed by permanent indefinite borrowing authority. This budget authority is not appropriated--in short, it is uncontrollable, given current practice.

7b) **In this regard, isn't S. 1679 preferable in requiring that if a direct loan is made by the FFB on the strength of an agency's guarantee, that direct loan is scored as such on the agency's budget, and cannot exceed the amount of budget authority provided for the purpose?**

The requirement in S. 1679 that FFB direct loans be shown in the originating agencies' accounts and not exceed budget authority provided will put these programs on the same footing as all other direct loans. Budget concepts will be neutral, making policy choices clearer.

8) **I'd also like to underscore one other point in your testimony. Opponents of this bill worry that when their off-budget activity is brought on-budget, there will be a sharp jump in budget authority and outlays, which may prompt excessive budget cutting. Yet, on page _, you note that this really will not happen because, at the same time the off-budget activity is brought on-budget, the prior year's data will also be shifted to the same basis. Thus, there should not be discontinuous upward jumps in Budget Authority and outlays "before" and "after" the proposed accounting changes.**

That is true. Normal budget procedures require changes in budget structure to be reflected historically to ensure that budget data are comparable over time.

BUDGET PRESENTATION BEFORE AND AFTER S. 1679
(Outlays in billions of dollars)

	1983 Before S. 1679		1983 After S. 1679	1984
	Agency	FFB	On-Budget	On-Budget
Foreign Military Sales	-0.1	2.8	2.8	4.1
Rural Electrification Administration	0.1	4.9	5.0	4.9
Agriculture Credit Insurance Fund	-0.4	1.0	0.6	-0.2
Rural Housing Insurance Fund	-*	2.4	2.4	2.4
Rural Development Insurance Fund	*	0.7	0.7	0.6

9) **Finally, I'd like to make one other point. You mention that had the Honest Budgeting Act been in effect in fiscal year 1982, federal outlays would have been 2 percent higher. In absolute dollar terms, however, the increase would have been substantial--$14 billion. In fact, almost $100 billion in federal spending has been hidden over the past decade by such "small" understatements produced by bad accounting.**

STATEMENT OF PETE DOMENICI, U.S. SENATOR FROM THE STATE OF NEW MEXICO

Senator DOMENICI. Thank you very much, Mr. Chairman.

Senator TRIBLE. Let me say at the outset we are pleased to have the distinguished chairman of the Senate Budget Committee, Senator Domenici. Your committee has pointed the way for this legislation for some time. We thank you for supporting this measure and for taking time to be here today to share your thoughts and ideas with us.

Senator DOMENICI. Senator, first I want to thank you for inviting me, and also congratulate you and the committee for treating this matter at this time.

Obviously, this is the kind of thing that one has a tendency to let slip, as we have many others, and not concern ourselves with it. But clearly, it should be of great concern, and you are assigning that kind of quality to it.

I want to apologize for being late this morning. I am sure you had some excellent witnesses. I was supposed to be here promptly at 10 a.m., but frankly, I was trying to model myself after Senator Proxmire, and trying to get in shape.

Senator PROXMIRE. You're looking in a lot better shape than I am.

Senator DOMENICI. I was out getting healthy, if that's possible.

First, so I don't forget, I want to share—Senator Chiles, who is the ranking Democrat on the Budget Committee, has a detailed statement. He supports the measure. He won't be here, because of a conflict. He asked me to put his statement in simultaneously with mine.

Senator TRIBLE. Senator Chiles' statement will be made a part of the record, as will your statement, Senator Domenici.

We welcome your comments at this time.

Senator DOMENICI. Mr. Chairman, I also have a little interesting chart that I had the staff work up which portrays the "Impact of off-budget FFB financing" in the fiscal year 1984 first budget resolution. The chart shows all of the functions that would be modified or changed in the 1984 budget if your bill became law. I would say, for you and the staff, that chart does not include REA. If you want to include REA, and you need something, the Budget Committee staff will give it to you. I am sure your staff knows the effect of REA on the effected function.

FFB OFF-BUDGET FINANCING DISTORTS BUDGET

Mr. Chairman, Senator Proxmire, and other members, I am pleased to testify in support of Senate bill 1679, Senator Trible's Honest Budgeting Act of 1983.

Nearly 10 years ago, as you know, Congress established the Federal Financing Bank, commonly known as the FFB, in the Treasury Department. It was an excellent idea, and still is. It was there in order to permit the Treasury Department to coordinate Federal agencies' borrowing from the public.

There had previously been enormous traffic jams in the credit markets caused by the increasing numbers and the bewildering variety of agency securities and the large volume of Treasury debt.

The FFB was empowered to buy securities issued by the Federal agencies, such as Postal Service, the Eximbank, and to borrow from Treasury to finance purchases of such agency debt. This procedure was designed to allow all Federal borrowing to be financed by the Treasury at less cost to the taxpayers and private borrowers. In the last decade, this procedure has worked well, saving considerable amounts of money through what we perceive to be lower interest rates on Federal borrowing, and the elimination of duplication of agency financial staffs.

Contrary to the original intent of Congress, as I understand it, the FFB has become an important source of off-budget financing for Federal direct loans to private borrowers made by or at the request of other agencies. This, as I again understand it, unintentional use of the FFB for off-budget financing distorts the budget process. That is why I support your bill. I don't think it was ever intended to be used in this manner, and I don't think we ought to continue.

It provides off-budget financing of direct loans in two ways: First by purchasing loan assets, called certificates of beneficial ownership, CBO's, from lending agencies. The Farmers Home Administration and Rural Electrification Administration sell nearly all the CBO's purchased by the FFB. Second, by making loans to private borrowers whose credit is backed by other agencies' guarantees of the loans. The largest FFB guaranteed loan financing is done for the Defense Department's foreign military sales program and for the REA.

These two aspects of the FFB's activity distort the budgetary process because Federal lending financed by the FFB does not appear in the unified budget or in the spending totals in congressional budget resolutions. The off-budget status of lending financed by the FFB undermines the integrity of the budget and Congress ability to make informed budget choices, if that be their desire. Sometimes I wonder whether it is, but nonetheless, we have to continue to assume it.

Sales of CBO's to the FFB by on-budget lending agencies, notably Farmers Home, offset the agencies' loan outlays, transferring that spending off-budget to the FFB. This reduces on-budget outlays and the deficit, leaving the perception of lower spending while in fact the reality is that total Government outlays remain the same.

Mr. Chairman and members of the committee, my statement goes on in some detail. I don't intend to read it all. I would ask that it be made a part of the record.

You can tell by the work I have done on this that I am a strong advocate of the unified budget and of the budget process. On the other hand, I am not one that doesn't think there's room for improving the unified budget and/or the budget process. There is room for improvement in both, but certainly to continue to permit the FFB to go off-budget as described is not one of those ways to improve it, in my opinion. In fact, it works to its detriment, in terms of giving a real picture to ourselves, to the American people, and to the agencies involved, of how much of the national budget they are using for their particular functions of government.

I would be pleased to try to answer any questions that you might have. I thank you very much for permitting me to testify.

Senator TRIBLE. Senator Domenici, as chairman of the Budget Committee and a distinguished colleague, we are pleased that you're here today. The point that you have made very eloquently is that to be truly effective the budget process must fully and accurately report the activities of the Federal Government, and that is our intention here, to help bring that to pass.

Senator DOMENICI. Senator, I also think, as Senator Proxmire has indicated many times, that the unified budget itself—as contrasted with the budget process—which is the budget that the National Government has followed since Lyndon Johnson's so-called unified budget, is distorted, whether we have a budget process or not, by the agencies' not putting those items in the budget. So regardless of what decisions we're going to make in the budget process here, it certainly would be helpful to have these items in the unified budget. We don't have a credit budget yet, as you know. We experiment with it. A binding credit budget would be much more effective than merely putting FFB financing on-budget, but even if we don't have a credit budget, which requires a change in the budget act itself, it certainly would be helpful to have this spending in the unified budget.

Senator TRIBLE. These two initiatives are not at all mutually exclusive, but rather will complement each other.

Senator DOMENICI. Absolutely.

Senator, if you'd like, there were a number of questions that were asked of us that we did produce the question and answer as far as my answer to questions—your staff submitted a number and we gathered up some. I would ask that they be made a part of the record. I think they explain some of the nuances in terms of guarantee versus direct loans.

Senator TRIBLE. The graph that you prepared and the questions and answers that you have submitted will all be made part of the record.

[The complete statements and documents follow:]

TESTIMONY OF SENATOR PETE V. DOMENICI ON

S. 1679, THE HONEST BUDGETING ACT OF 1983

SEPTEMBER 19, 1983

CHAIRMAN GARN, SENATOR PROXMIRE, AND DISTINGUISHED MEMBERS OF THE COMMITTEE, I AM PLEASED TO TESTIFY THIS MORNING IN SUPPORT OF S. 1679, SENATOR TRIBLE'S HONEST BUDGETING ACT OF 1983.

AS YOU KNOW, NEARLY TEN YEARS AGO THE CONGRESS ESTABLISHED THE FEDERAL FINANCING BANK (OR FFB) IN THE TREASURY DEPARTMENT TO COORDINATE FEDERAL AGENCY BORROWING FROM THE PUBLIC. THE IDEA WAS TO ELIMINATE THE "TRAFFIC JAM" IN THE CREDIT MARKETS CAUSED BY THE INCREASING NUMBER AND BEWILDERING VARIETY OF AGENCY SECURITIES AND THE LARGE VOLUME OF TREASURY DEBT.

THE FFB WAS EMPOWERED TO BUY SECURITIES ISSUED BY FEDERAL AGENCIES SUCH AS THE POSTAL SERVICE AND THE EX-IM BANK AND TO BORROW FROM THE TREASURY TO FINANCE PURCHASES OF SUCH AGENCY DEBT. THIS PROCEDURE WAS DESIGNED TO ALLOW ALL FEDERAL BORROWING TO BE FINANCED BY THE TREASURY, AT LESS COST TO THE TAXPAYERS AND TO PRIVATE BORROWERS. IN THE LAST DECADE THIS PROCEDURE HAS WORKED WELL, SAVING MONEY

THROUGH LOWER INTEREST RATES ON FEDERAL BORROWING AND THE ELIMINATION OF NEEDLESS DUPLICATION OF AGENCY FINANCIAL STAFFS.

CONTRARY TO THE ORIGINAL INTENT OF CONGRESS, AS I UNDERSTAND IT, THE FFB ALSO HAS BECOME AN IMPORTANT SOURCE OF OFF-BUDGET FINANCING FOR FEDERAL DIRECT LOANS TO PRIVATE BORROWERS MADE BY OR AT THE REQUEST OF OTHER AGENCIES. THIS UNINTENTIONAL USE OF THE FFB FOR OFF-BUDGET FINANCING DISTORTS THE BUDGETARY PROCESS. THAT IS WHY I SUPPORT S. 1679.

THE FFB PROVIDES OFF-BUDGET FINANCING OF DIRECT LOANS IN TWO WAYS:

- FIRST, BY PURCHASING LOAN ASSETS (CALLED CERTIFICATES OF BENEFICIAL OWNERSHIP OR CBOs) FROM LENDING AGENCIES. THE FARMERS HOME ADMINISTRATION AND THE RURAL ELECTRIFICATION ADMINISTRATION SELL NEARLY ALL THE CBO'S PURCHASED BY THE FFB.
- SECOND, BY MAKING LOANS TO PRIVATE BORROWERS WHOSE CREDIT IS BACKED BY OTHER AGENCIES' GUARANTEES OF THE LOANS. THE LARGEST FFB GUARANTEED LOAN FINANCING IS DONE FOR THE DEFENSE DEPARTMENT'S FOREIGN MILITARY SALES PROGRAM AND FOR REA.

THESE TWO ASPECTS OF THE FFB'S ACTIVITY DISTORT THE BUDGETARY PROCESS BECAUSE FEDERAL LENDING FINANCED BY THE FFB DOES NOT APPEAR IN THE UNIFIED BUDGET OR IN THE SPENDING TOTALS IN CONGRESSIONAL BUDGET RESOLUTIONS. THE OFF-BUDGET STATUS OF LENDING FINANCED BY THE FFB UNDERMINES THE INTEGRITY OF THE BUDGET AND THE CONGRESS' ABILITY TO MAKE INFORMED BUDGET CHOICES.

SALES OF CBOs TO THE FFB BY ON-BUDGET LENDING AGENCIES, NOTABLY FARMERS HOME, OFFSET THE AGENCIES' LOAN OUTLAYS, TRANSFERING THAT SPENDING OFF-BUDGET TO THE FFB. THIS REDUCES ON-BUDGET OUTLAYS AND THE DEFICIT, LEAVING <u>THE PERCEPTION</u> OF LOWER SPENDING, WHILE IN FACT <u>THE REALITY</u> IS THAT TOTAL GOVERNMENT OUTLAYS REMAIN THE SAME.

(FFB PURCHASES OF CBOs FROM REA TRANSFER LOAN OUTLAYS FROM REA TO THE FFB IN THE SAME WAY, BUT SINCE REA IS ALREADY OFF-BUDGET BY STATUTE, NO CHANGE IN ON-BUDGET SPENDING OR THE DEFICIT OCCURS).

WHEN THE FFB MAKES LOANS GUARANTEED BY OTHER AGENCIES, FEDERAL OUTLAYS OCCUR. HOWEVER, THE OUTLAYS ARE CHARGED TO THE FFB, NOT THE AGENCY REQUESTING THE LOAN, WHICH ONLY RECORDS A LOAN GUARANTEE. WHEN THE GUARANTEEING AGENCY IS <u>ON-BUDGET</u>, THIS PRODUCES

THE PERCEPTION THAT THE GOVERNMENT HAS PROVIDED ASSISTANCE WITH A LOAN GUARANTEE, WHILE THE REALITY IS THAT THE GUARANTEE HAS BEEN CONVERTED INTO AN OFF-BUDGET DIRECT LOAN.

(THE FFB FINANCES LOANS GUARANTEED BY REA IN THE SAME WAY. SUCH LOANS WOULD BE OFF-BUDGET IF MADE DIRECTLY BY REA).

BOTH OF THESE FORMS OF FFB FINANCING OF FEDERAL DIRECT LOANS FOR OTHER AGENCIES UNDERMINE THE INTEGRITY OF THE BUDGET BY UNDERSTATING FEDERAL SPENDING AND THE DEFICIT. THE COST OF FEDERAL CREDIT ASSISTANCE FINANCED BY THE FFB IS "HIDDEN" OFF-BUDGET, RATHER THAN DISPLAYED IN THE BUDGETS OF THE AGENCIES UTILIZING THAT FINANCING.

OFF-BUDGET FEDERAL SPENDING IS, BY DEFINITION, OUTSIDE THE CONGRESSIONAL BUDGET PROCESS. WHEN THE CONGRESS CONSIDERS THE APPROPRIATE LEVELS OF FEDERAL SPENDING AND THE DEFICIT, THE OUTLAYS OF THE FFB AND OTHER OFF-BUDGET AGENCIES ARE NOT COUNTED, AND THE TRUE SIZE OF GOVERNMENT ACTIVITY IS NOT CONSIDERED. WHEN THE CONGRESS MAKES DECISIONS ABOUT THE DISTRIBUTION OF FEDERAL SPENDING AMONG THE DIFFERENT AREAS OF THE ECONOMY, OUTLAYS OF THE FFB AND OTHER OFF-BUDGET AGENCIES THAT SUPPORT AGRICULTURE, HOUSING, NATIONAL DEFENSE AND OTHER AREAS ARE NOT CONSIDERED, AND THE TRUE LEVEL OF

FEDERAL ASSISTANCE TO THOSE AREAS IS NOT TAKEN INTO ACCOUNT.

LENDING PROGRAMS FINANCED OFF-BUDGET THROUGH THE FFB HAVE AN UNFAIR ADVANTAGE OVER PROGRAMS FINANCED DIRECTLY FROM THE GENERAL FUND OF THE TREASURY. WITHOUT MORE COMPLETE DISCLOSURE OF THE BUDGETARY COST OF FEDERAL PROGRAMS AND THE ASSISTANCE PROVIDED TO DIFFERENT ELEMENTS OF SOCIETY, THE CONGRESS CANNOT MAKE INFORMED BUDGETARY DECISIONS.

S. 1679, SENATOR TRIBLE'S HONEST BUDGETING ACT OF 1983, WOULD AMEND THE FFB ACT TO IMPROVE THE BUDGETARY TREATMENT OF FFB FINANCING OF FEDERAL DIRECT LOANS. UNDER THE BILL, FFB OUTLAYS RESULTING FROM PURCHASES OF CBOS OR ORIGINATION OF GUARANTEED LOANS WOULD BE CHARGED TO THE OTHER FEDERAL AGENCIES INITIATING THE TRANSACTIONS. SUCH FFB OUTLAYS ALSO COULD NOT EXCEED BUDGET AUTHORITY PROVIDED TO THOSE AGENCIES TO FINANCE THE LOANS.

THE EFFECT OF THIS CHANGE WOULD BE TO SHOW THE BUDGET IMPACT OF FFB FINANCING OF DIRECT LOANS WHERE IT LOGICALLY BELONGS: IN THE BUDGETS OF AGENCIES INITIATING THE LENDING. THE CHANGE WOULD MAKE THE BUDGET A MUCH MORE ACCURATE MEASURE OF FEDERAL SPENDING AND THE FEDERAL DEFICIT, AND WOULD ALLOW THE BUDGET TO PORTRAY

MORE COMPLETELY TOTAL FEDERAL ASSISTANCE TO INDIVIDUAL PROGRAM AREAS. THIS GREATER BUDGETARY DISCLOSURE SHOULD IMPROVE IN TURN THE CONGRESS' ABILITY TO MAKE INFORMED BUDGETARY DECISIONS.

FOR THESE REASONS -- GREATER ACCURACY IN THE BUDGET AND MORE RESPONSIBLE BUDGETING BY THE CONGRESS -- I STRONGLY SUPPORT S. 1679, AS I DID EARLIER LEGISLATION INTRODUCED BY SENATORS PROXMIRE AND GORTON, S. 711. AS CHAIRMAN OF THE SENATE BUDGET COMMITTEE, I COMMEND ALL THREE SENATORS AND THIS COMMITTEE FOR YOUR EFFORTS TO IMPROVE THE BUDGET AND THE BUDGET PROCESS.

ALTHOUGH THE BUDGET AND GOVERNMENTAL AFFAIRS COMMITTEES DO NOT HAVE LEGISLATIVE JURISDICTION OVER THE FFB ACT, BOTH COMMITTEES HAVE A STRONG INTEREST IN LEGISLATION SUCH AS S. 1679 WHICH WOULD EFFECT THE CONTENTS OF CONGRESSIONAL BUDGET RESOLUTIONS. THEREFORE, THE COMMITTEES HAVE REQUESTED REFERRAL OF S. 1679 TO HAVE AN OPPORTUNITY TO SUGGEST MODIFICATIONS IN THE BILL AND TO MAKE A WRITTEN REPORT TO THE SENATE.

ALSO, MR. CHAIRMAN, LET ME SUGGEST A SMALL CHANGE TO SECTION 2 OF S. 1679 THAT I BELIEVE IS APPROPRIATE. AS SECTION 2 NOW READS, IT CAN BE INTERPRETED AS REQUIRING NOT ONLY THAT FFB FINANCING OF

REQUESTED BY REA BE SHOWN IN REA'S BUDGET, BUT ALSO THAT REA ITSELF BE BROUGHT ON-BUDGET. UNDER THIS BROAD INTERPRETATION, SECTION 2 OVERTURNS THE PROVISION OF THE RURAL ELECTRIFICATION ACT THAT NOW EXCLUDES REA FROM THE BUDGET.

I AM CONCERNED ABOUT ALL OFF-BUDGET SPENDING, INCLUDING THAT OF REA. HOWEVER, IT SEEMS TO ME THAT THE MOST IMPORTANT GOAL OF S. 1679 -- TO REQUIRE THAT FFB OUTLAYS TO FINANCE DIRECT LOANS BE SHOWN IN THE BUDGETS OF THE AGENCIES INITIATING THE LENDING -- COULD BE JEOPARDIZED BY ATTEMPTING TO BRING REA ON-BUDGET AS WELL. I WOULD PREFER THAT THE CONGRESS ADDRESS THAT ESSENTIALLY SEPARATE ISSUE THROUGH AN AMENDMENT TO THE RURAL ELECTRIFICATION ACT, RATHER THAN THROUGH A CHANGE IN THE FFB ACT.

FINALLY, MR. CHAIRMAN, LET ME SAY THAT SENATOR CHILES, THE RANKING MINORITY MEMBER OF THE BUDGET COMMITTEE, ALSO SUPPORTS S. 1679. HOWEVER, HE HAS A CONFLICT AND CANNOT APPEAR BEFORE THE COMMITTEE THIS MORNING. HE ASKED ME TO REQUEST THAT HIS PREPARED STATEMENT BE MADE PART OF THE HEARING RECORD.

THANK YOU AGAIN FOR THIS OPPORTUNITY TO TESTIFY BEFORE YOUR COMMITTEE, MR. CHAIRMAN. I WOULD BE PLEASED TO ANSWER ANY QUESTIONS ANYONE MAY HAVE.

Responses to Questions on S. 1679.

Q: Qualitatively, how important is the distortion of budget realitites, by aggregate and by function, if we continue to allow FFB-financed spending to be excluded from the budget?

A: The FFB finances only about 1 to 1½ percent of federal spending, a small proportion. However, FFB-financed lending has grown faster in the last ten years than any other federal spending, and the potential for future growth is great. Also, the FFB finances nearly 25 percent of Function 150, International Affairs, and large portions of others.

Q: If S. 1679 is not passed, won't there be a tendency to want to escape hard budget choices by relying more on hidden spending?

A: If we look at the explosive growth of FFB-financed lending over the past decade, I think the answer is "yes", there will be more pressure for off-budget spending.

Q: S. 1679 requires outlays of all loan programs financed through the FFB to be included in the unified budget, as well as the agencies' budgets. Is this appropriate?

A: As I mentioned in my testimony, this would override the Rural Electrification Act, which excludes REA from the unified budget. I believe the off-budget status of the REA should be considered by the Agriculture Committee, which has jurisdiction over that law.

Q: The FFB makes loans guaranteed by other agencies. This bill would require that FFB outlays resulting from those loans be shown in the agencies' budgets. Is that appropriate?

A: Yes. The loans are made at the request of and are backed and serviced by the agencies that guarantee them. From a budgetary perspective, the loans are equivalent to direct loans made by the agencies and financed through borrowing from the FFB. S. 1679 would require that the agencies' budgets reflect this budgetary reality.

Q: Some arue that the limits put on credit programs in the appropriations process are an effective way of controlling off-budget FFB spending. Is this true?

A: No, it's not. Although the appropriation limits on credit programs financed by the FFB are part of the credit budget, the aggregate credit targets set by Congress are not binding. Thus the scrutiny of program needs and the competition for scarce resources that occurs on the spending side does not occur to the same degree on the credit side. Even if we amended the Budget Act to make the credit budget binding, however, the spending impact of FFB financing still would not be shown in the unified budget. The unified budget must reflect the spending impact of FFB financing for Congress to make informed decisions.

Q: This bill makes the budgetary accounting change effective in FY 1985. Is that enough time for the Budget Committee to plan?

A: Since this is a change in budgetary accounting, not policy, that is plenty of time.

Impact of off-budget FFB financing

FY 1984 Outlays
($ billions)

	First Budget Resolution	FFB [a/]	First Bud Resoluti with FF
Functions			
150: International Affairs	12.9	3.1	16.0
250: General Science, Space and Technology	8.3	-0.1	8.2
270: Energy	4.3	0.7	5.0
350: Agriculture	11.5	0.5	12.0
370: Commerce and Housing Credit	2.2	2.7	4.9
400: Transportation	26.0	(*)	26.0
450: Community and Regional Development	8.1	0.8	8.9
550: Health	32.0	-(*)	32.0
600: Income Security	102.3	-(*)	102.3
All Other	641.9	---	641.9
TOTAL	849.5	7.7	857.2

(*) Less than $50 million

[a/] Does not include FFB outlays resulting from transactions with the Rural Electrification Administration (Function 270) or the Rural Telephone Bank (Function 450), since these agenices' spending is excluded from the unified budget by separate statute.

TESTIMONY OF SENATOR LAWTON CHILES

ON

S.1679, THE HONEST BUDGETING ACT OF 1983

SEPTEMBER 19, 1983

Mr. Chairman, I'm pleased to be a cosponsor of S.1679, the Honest Budgeting Act of 1983, and I appreciate the chance to present testimony before the Senate Committee on Banking, Housing, and Urban Affairs.

Certainly Senator Trible deserves our respect for proposing this legislation. Although he has been a member of the Senate less than one year, he has already made good use of the previous six years he spent in the House of Representatives and the term he served as a member of the House Budget Committee. S.1679 is a testament to his experience.

The bill aims to convert much of the borrowing activity of federal agencies from so-called "off budget" transactions into the unified federal budget. Nine years ago, the Federal Financing Bank was established to centralize financing authority for marketable federal securities. Although it was originally thought FFB activities would amount to around $6 billion annually, outstanding loans totaled more than $107 billion by the end of 1981.

On the plus side, FFB loans offer lower interest rates to federal agencies than available if their securities were sold on the open market. The down side is that since FFB transactions are considered off-budget, the funds it expends are counted

neither in initiating agency budgets nor in the unified budget. As a consequence while we save millions in interest payments annually, we are distorting the budget picture and hiding billions in outlays by putting them "off-budget".

At present, the only credit activities subject to Congressional control in the unified budget are on-budget direct loans and default payments under loan guarantees. But, the larger share of direct federal lending, by far, is accomplished through off-budget FFB loans to borrowers who have obtained loan guarantees from a federal agency. FFB purchase of agency-guaranteed loans converts guarantees into direct loans of FFB. Due to the off-budget nature of the FFB and because agency guarantees do not constitute an outlay, these transactions do not appear in the unified budget.

This practice of allowing federal agencies convert loan guarantees into direct loans is a matter of extreme concern for many reasons. Each year, federal agencies with access to FFB are able to increase their direct lending without requesting additional budget authority. Since loan guarantees which are contingent liabilities can be converted into direct loans requiring direct federal outlays and federal borrowing, Congressional control of outlays and contingent liability is undetermined.

26-196 O—83——6

The guarantee into loan process also creates a double subsidy to borrowers which Congress may not have intended. This occurs because with a guarantee, a borrower can borrow more cheaply than he can without federal assistance; with a direct loan from FFB, that borrower gets the added benefit of further interest rate reduction, since FFB lends at one-eighth of a percentage point above the Treasury's own cost of funds. Finally, and perhaps most objectionable, the converting of guarantees into direct loans leads to significant underepresentation of agency outlays, federal outlays and the federal deficit.

Compounding the guarantee to direct loan difficulties created by certain FFB transactions, the FFB is also the principal purchaser of loan assets sold by federal agencies. By selling loans to the FFB, agencies are able to convert loans from on-budget outlays to off-budget FFB expenditures. Moreover, since accounting provisions allow agencies to offset outlays with receipts from sales, agencies can effectively extend far more credit than they are legally authorized.

As a result of the budgetary treatment of FFB loan asset sales and direct loans to guaranteed borrowing each year, select federal agencies are able to undertake activities far beyond the financial limits established by their direct appropriations. And equally disturbing, those outlays in the end, are not reflected

in the unified budget. A recent CBO study, for example, reported that in 1980, the Farmers Home Administration reported outlays of $3.0 billion. Not included in that figure was an additional $6.9 billion in loans financed through loan asset sales to the FFB. If these outlays had been charged to FmHA, its outlays would have increased three-fold.

In terms of total federal spending, FFB transactions significantly understate the federal government's total borrowing needs as reflected in the unified budget deficit. For example, in 1981, the unified budget deficit underrepresented the total deficit (unified deficit plus FFB deficit) by fully $21 billion. For both 1982 and 1983, nearly $14 billion each year will be unaccounted for in the unified budget deficit.

Although S.1679 addresses several other credit issues, it's core value is clear. It moves to refocus control of credit outlays directly under the supervision of Congress. And it eliminates a sizeable portion of the underestimates now plaguing the budget.

Bad as our deficits are right now -- in excess of $200 billion -- even that dismal level is lower than the facts if the activities of the FFB are brought into the budget. The fact is, Mr. Chairman, we can't fight the federal deficits with accounting magic. We've got to have both political courage and accurate

figures. The courage must come to each of us separately. But we can do something about accuracy by acting in unison to approve S.1679.

Some years ago, I authored the Government in the Sunshine Act, the law that opened up agency hearings to the public. It was my belief both then and now that sunshine is the best disinfectant. If the public has a true grasp of what goes on in government, their judgement can be trusted to support remedies or improvements to correct our problems.

There should be no doubt our economic problems are severe. For some months now we've been riding the crest of economic recovery. We saw interest rates decline, we saw housing and auto sales revive, and business inventories shrink. Things looked pretty good. But then came the word that the federal deficit would be more than $200 billion this fiscal year.

Now we see interest rates inching back up. Recent reports show auto sales less vigorous than they have been, and housing starts have fallen back in the face of those climbing interest rates. The key gremlin in the slowing of recovery is the size of the federal deficit.

The days of argument about "crowding out" are over. This summer the minority staff of the Senate Budget Committee responded to a Treasury report that claimed deficits didn't matter. The Budget Committee makes it very clear that deficits matter in a critical way. For one thing, the Committee study showed that the federal deficit is currently eating up 97 percent of all net savings in the United States. That, Mr. Chairman, is the superlative form of "crowding out". It's the kind of crowding that denies private borrowers access to credit, and overprices what remains by driving up interest rates. So deficits really do matter.

The Senate Budget Committee showed us something else. In the 1960's when the federal deficit accounted for 0.8 percent of the Gross National Product, interest rates were at four percent. Between 1980 and 1982, when the deficit rose to 2.5 percent, interest rates shot up to 12.1 percent. If Congress is unable to enforce the budget we've already passed, the deficit will surge to 6.3 percent of GNP in the immediate future. You can imagine what that will do to interest rates if history is any guide.

Yes, deficits matter, and fighting those deficits matters even more. I believe S.1679 will help give us a true picture of federal deficits, painful though that picture may be.

Even so, we don't really have much hope of addressing the deficit problem in an effective way without an accurate picture of how large the problem really is. We need this legislation, and we need to enforce the budget. Unless we get moving right now by passing this bill and enforcing our budget, the economic recovery will stop moving altogether.

As a final comment, Mr. Chairman, I would like to join with Senator Domenici in suggesting a small change to Section 2 of S.1679 as it pertains to the Rural Electrification Administration. Under a broad interpretation of Section 2, REA which is an off-budget entity by separate statute, would be brought on-budget, thus overturning the provision of the Rural Electrification Act that currently excludes REA from the unified budget. I do not believe that particular change is integral to this bill, and would not be wise at this point in time. I would therefore recommend that section 2 be revised to clarify that it does not affect the current status of REA.

Senator TRIBLE. Senator Proxmire?

THE REA EXCLUDED FROM THE LEGISLATION

Senator PROXMIRE. Chairman Domenici, I want to thank you very much for coming before the committee. I realize it's Monday morning, right off the bat. Your coming in and giving us your time, showing your concern, and support of this approach, this legislation is appreciated—it's a fine statement. The only part of it that troubles me is the part that I disputed to some extent with Senator Gorton also. That is on page 7, where you point out that you would, in my judgment, pretty much exclude the Rural Electrification System, apparently for reasons of political realism. I certainly greatly admire the REA. There is no agency that has done more for our farmers.

On the other hand, the table that Mr. Penner gave us shows that of the $14 billion in FFB outlay, $4½ billion of that, or about 30 percent, is for the REA. That would make this bill the "70-Percent Honesty in Budgeting Act," rather than 100-percent honesty in budgeting act. I just wonder if that's logical, and the difficulty is that we were excluding this, in my judgment, because of the political realism and because of the pressure by political groups, because of the fact the Agriculture Committee wanted to take a look at this, and so forth.

I understand all of that, of course, but it seems to me it's going to make it very, very hard for us to maintain the integrity of this legislation because I think other groups will say: Look at the REA. They get an exception. Why shouldn't we?

Senator DOMENICI. Well, Senator, I don't think I can do any better in explaining it than I did in the written remarks. You have them before you.

I guess what I would say is it is better to get a large portion than to get nothing, in terms of this effort. I do believe unless you are willing to send this bill to Agriculture, which clearly wrote the substantive law with reference to REA, I don't believe you can achieve your goal in a rather quick and expeditious manner. I do believe REA historically has had the treatment that it now has. It isn't a new thing that occurred because of the FFB. Some of the others are new.

Because of the way we have treated the FFB financing, they were never intended—clearly, REA was the opposite. It was not intended to be part of the unified budget. That's the only answer I can give you.

Senator PROXMIRE. It was not intended to be in the unified budget? Do you think the original intention is right?

Senator DOMENICI. Well, let me just—at one point, I said to you that there is nothing miraculously perfect about the unified budget.

For instance, I think it's time we start looking at capital improvements in the unified budget. I don't know how we have to. I surely don't want to look at them in terms of the way some people want to look at them: to make it a lot easier to debt finance capital improvement and not count the debt.

But clearly, we can't accomplish everything we would like with reference to this budget, and the REA was never intended to be on. But many of these other programs were. There is not a great deal of difference, however, in the final analysis, to answer your question.

Senator PROXMIRE. Let me give you an analogy that might illustrate the difficulty here. What would be the effect on tax revenues if the Finance Committee allowed the other standing committees to write tax subsidy laws for the programs under their jurisdiction?

Senator DOMENICI. It would be devastating.

Senator PROXMIRE. That's exactly what I am afraid of here. I share your strong support. I think all of us feel strong support for the REA. Anybody who has watched that development must agree that a marvelous job was done for our farmers.

But again, I apologize for bringing this up, because I think your statement generally is an excellent statement, and I am very, very pleased that you have come before the committee. I think you do make a strong point. If we can get 70 percent, that's better than getting nothing.

Senator DOMENICI. Please don't concern yourself by asking me about it. I get asked about all of these things all of the time. [Laughter.]

Senator TRIBLE. Pete, we thank you very much for being with us this morning.

Senator DOMENICI. Appreciate it.

Senator TRIBLE. Next, Mr. Harry Havens, Assistant Comptroller General, General Accounting Office.

STATEMENT OF HARRY HAVENS, ASSISTANT COMPTROLLER GENERAL, GENERAL ACCOUNTING OFFICE

Mr. HAVENS. Good morning, Mr. Chairman.

Senator TRIBLE. Good morning, Mr. Havens. Pleased to have you back with us again.

Mr. HAVENS. Thank you, Mr. Chairman. I apologize in advance. My voice cracks at various points.

Senator TRIBLE. We have a glass of water before you. Take your time. We don't want you to expire before the Banking Committee. It would be the first time that occurred.

Mr. HAVENS. Thank you, sir.

We appreciate the opportunity to testify on the budget treatment of FFB and specifically on your bill, S. 1679. This bill would require that the receipts and disbursements of the FFB be included in the Federal budget and charged to the program agency.

We support this objective. It will increase the visibility of the Government's credit activities and will make the budget reflect more accurately the activities of the Government.

I will skip over some of the background, if I may, in the interest of time, because it's been covered by prior witnesses and by ourselves on previous occasions.

We favor the principal objective of the bill, but we believe certain changes would help accomplish the desired result. As presently written in S. 1679, loan guarantee amounts financed by the FFB shall not exceed amounts of budget authority provided to the Fed-

eral agency for such purposes. However, the statutory definition of "budget authority," as stated in section 3(a)(2) of the Congressional Budget Act of 1974, specifically excludes loan guarantee amounts from "budget authority." Attached to my statement is a suggested revision which we believe would resolve this possible statutory conflict.

We also suggest that the legislative history of the bill make it clear that "means of financing" refers to agency borrowing from the FFB which affects the agency balance sheet by increasing cash and increasing liabilities. Transactions treated as a means of financing do not reduce outlays and budget authority as do transactions treated as the sale of an asset.

Finally, the last major provision would provide that if agencies used the FFB between October 1, 1981, and September 30, 1984, then in the future they must also utilize the FFB. We agree with the objective of this provision, to assure that agencies continue to use the FFB, where appropriate. We note, however, that the provision might be interpreted as being applicable only to agencies which used the FFB during that particular period. We suggest that the legislative history make it clear that the provision is applicable, for example, to a new agency—created after 1984—if that agency issued, sold, or guaranteed obligations of a type currently financed by the FFB.

We also note that the regulatory powers vested in the executive branch are quite strong. We suggest that you monitor the implementation of the bill to assure consistency with congressional intent.

With the changes we have suggested, and with the additional items of legislative history, we would recommend enactment of the bill. That completes my prepared statement.

I would be happy to try to answer any questions you have.

Senator TRIBLE. Mr. Havens, thank you very much. I am interested in defining the regulatory authorities as narrowly as possible to achieve budgetary purposes set forth in this measure.

I am struck by your words, that the regulatory powers in S. 1679 are quite strong, and suggesting that they be monitored by this committee. What is it that you are attempting to say there?

Mr. HAVENS. Well, our point is that the language of the FFB Act as added by section 3 of the bill, says that the Secretary of the Treasury shall issue regulations to carry out provisions of the subsection. The subsection addresses who is subsequently required to operate through the FFB.

Now, I think it would be very difficult to write legislation which would be more specific than is currently there. When you say obligation of a type which was, during a particular period, issued, sold, or guaranteed and financed through the bank, that is subject to substantial ambiguity or interpretation, and I think necessarily so, in order to achieve the objective you're after. But the Secretary is going to have to define what that is, and will have to apply those regulations in particular instances. Now, given a Secretary who is carrying out the ministerial functions, approaching them in a ministerial fashion, I don't think there's a problem, but regulations frequently get interpreted in ways that are more than ministerial,

and I am suggesting that some review of what happens under the regulations would be useful in the long run.

Senator TRIBLE. You are recommending vigilance on the part of the Congress?

Mr. HAVENS. I am, sir.

Senator TRIBLE. Senator Proxmire?

Senator PROXMIRE. Thank you very much, Mr. Havens, for a good statement. I am delighted you support this effort on our part. Thank you, sir.

Mr. HAVENS. Thank you.

Senator TRIBLE. Mr. Havens, we thank you for your testimony today.

[The complete statement follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D. C. 20548

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M.
September 19, 1983

STATEMENT OF

HARRY S. HAVENS

ASSISTANT COMPTROLLER GENERAL

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

ON THE

HONEST BUDGETING

ACT OF 1983

S. 1679

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to testify before your Committee on the budget treatment of the Federal Financing Bank (FFB) and specifically on S. 1679.

This bill would require that the receipts and disbursements of the FFB be included in the Federal budget and charged to the program agency.

We support this objective. It will increase the visibility of the Government's credit activities and will make the budget reflect more accurately the activities of the Government.

If the provisions of S. 1679 had been in effect during fiscal year 1982, net budget outlay totals of some 15 agencies would have gone up about $14 billion. In our view, the loss of visibility was an undesirable side-effect of the way FFB was created. Nevertheless, the original objective of having an FFB--to achieve better coordination of the Government's borrowing activities--is still valid and should be preserved. We believe that S. 1679 is an appropriate solution to the problem.

Our views on this bill are based on work we have done concerning Federal credit programs over a period of several years. In the interest of brevity I will not elaborate on this work, but I have attached a list of relevant reports, hearing statements and bill comments. In addition we are currently conducting a review of FFB's impact on credit and debt management issues.

We would be happy to discuss our work further with you or your staff, if that would be helpful.

Provisions of S. 1679

The major provisions of S. 1679 would

--Require that all transactions of the FFB be included in the unified budget totals of the responsible Federal agencies, with amounts disbursed by the FFB being treated as a means of financing the responsible Federal agency;

--Require the Director of the Office of Management and Budget (OMB) to issue regulations to carry out the above provision; and

--Require that an obligation of a type which was, during the period from October 1, 1981 to September 30, 1984, issued, sold, or guaranteed and financed through the FFB be offered for sale in

the future first to the FFB before going to the private market, with regulatory authority vested in the Secretary of the Treasury.

We favor including FFB transactions in the unified budget totals and charging those agencies which provide guarantees to repay the FFB funds. However, we believe that certain changes are needed to accomplish the desired result. As presently written in S. 1679, loan guarantee amounts financed by the FFB shall not exceed amounts of budget authority provided to a Federal agency for such purposes. However, the statutory definition of budget authority, as stated in section 3(a)(2) of the Congressional Budget Act of 1974, specifically excludes loan guarantee amounts from budget authority. Attached to my statement is a suggested revision which we believe would resolve this statutory conflict.

We also suggest that the legislative history of the bill make it clear that "means of financing" refers to agency borrowing from the FFB which affects the agency balance sheet by increasing cash and increasing liabilities. It is not intended to be treated as an offset to outlays and budget authority totals. Treating FFB transactions as borrowing will require an increase in agency budget totals because borrowing must be authorized through the budget process and is scored as budget authority.

And finally, the last major provision would provide that if agencies used the FFB between October 1, 1981, and September 30, 1984, then in the future they must also utilize the FFB. We agree with the objective of this provision, to assure that

agencies continue to use the FFB, where appropriate. We note, however, that the provision could be interpreted as being applicable only to agencies which used the FFB during a particular period. We suggest that the legislative history make it clear that the provision is applicable, for example, to a new agency (created after 1984) if the agency issued, sold, or guaranteed obligations of a type currently financed by the FFB.

We also note that the regulatory powers vested in the executive branch are quite strong. We suggest that you monitor the implementation of the bill to assure consistency with congressional intent.

With the changes we have suggested we would recommend enactment of this bill.

Mr. Chairman, this concludes my prepared statement. I would be pleased to try to answer any questions.

ATTACHMENT 1

ATTACHMENT 1

GAO PRODUCTS ON THE FEDERAL FINANCING BANK

U.S. General Accounting Office, "Government Agency Transactions with the Federal Financing Bank Should Be Included in the Budget" (PAD-77-70, August 3, 1977).

Testimony before the Subcommittee on Oversight of the House Committee on Ways and Means on the budget treatment of the Federal Financing Bank, H.R. 7416, September 20, 1977.

U.S. General Accounting Office, "Legislative Changes Needed to Improve Budget Treatment of Certificates of Beneficial Ownership" (PAD-80-32, April 9, 1980).

U.S. General Accounting Office, "Federal Budget Totals Are Understated Because of Current Budget Practices (PAD-81-22, December 31, 1980).

U.S. General Accounting Office comments on S. 2162, a bill to include Federal Financing Bank amounts in budget totals and change the treatment of certain transactions, August 20, 1982.

Testimony before the Subcommittee on Federal Credit Programs, Senate Committee on Banking, Housing, and Urban Affairs on the Federal Financing Bank, April 5, 1983.

Testimony before the House Committee on Ways and Means on the budget treatment of the Federal Financing Bank, H.R. 2868, May 12, 1983.

ATTACHMENT 2

"(c) All transactions of the Bank shall be reflected in the unified budget of the United States Government. Amounts which are disbursed by the Bank for the purchase of loans guaranteed, loan assets sold, and debt obligations issued, by a Federal agency shall be treated as borrowing and a means of financing that agency. Such amounts shall be disbursed by the Bank to the Federal agency and redisbursed by the Federal agency as loans to qualified public borrowers. Amounts which are disbursed for loans by a Federal agency and which are financed by the Bank shall be recorded as outlays of that agency and the amounts of such loans shall not exceed the amounts of budget authority provided to the agency for the purpose of making these kinds of loans. The Director of the Office of Management and Budget shall issue regulations to carry out the provisions of this subsection."

Senator TRIBLE. Mr. Havens is the last of the witnesses in the morning session. The committee will reconvene this afternoon at 2 o'clock.

[Whereupon, at 11:15 a.m., the hearing was recessed, to resume at 2 p.m. this same day.]

AFTERNOON SESSION

Senator TRIBLE. Good afternoon. Welcome to the afternoon session. This is the full committee hearing of the Committee on Banking, Housing and Urban Affairs. Our purpose today is to hear testimony on Senate bill 1679.

A large part of the spending activities of the Federal Government does not show up in the Federal budget. It is off budget and, therefore, largely obscured from congressional oversight. The outlays of the Federal Financing Bank represent most of the off-limit outlays of the Federal Government. In less than 10 years the Federal Financing Bank has financed $97 billion in off-budget spending.

The purpose of the Honest Budgeting Act of 1983 is to place these activities on budget. This morning we heard from Senators Pete Domenici and Slade Gorton in support of this measure. We heard from Joseph Wright, the Deputy Director of the Office of Management and Budget; Rudy Penner, the Director of the Congressional Budget Office; and Harry Havens, the Assistant Comptroller General from the General Accounting Office.

This afternoon we will begin again this process. Our first witness is the distinguised Virginian, Mr. Guy Lewis, who is the president of the National Rural Electric Cooperative Association.

Guy, you are most welcome. Your statement will be made part of the record. Please read your statement or summarize your testimony if you choose to do so.

I would ask you to introduce for the sake of the record your two able associates.

STATEMENT OF GUY C. LEWIS, JR., PRESIDENT, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION, ACCOMPANIED BY DON SMITH, STAFF ECONOMIST; AND CHARLOTTE M. WILMER, LEGISLATIVE REPRESENTATIVE

Mr. LEWIS. On my right, Don Smith, chief economist of NRECA; on my left, Charlotte Wilmer, legislative representative.

Senator TRIBLE. We are pleased that you are here, and the floor is yours.

Mr. LEWIS. Thank you, Mr. Chairman.

Mr. Chairman and distinguished members of the Banking, Housing and Urban Affairs Committee, my name is Guy C. Lewis, Jr. I am president of the National Rural Electric Cooperative Association, a voluntary national service organization comprised of nearly 1,000 rural electric cooperatives which operate in 46 States and serve more than 25 million consumer members.

It is an honor for me to have this opportunity to present the views of NRECA on S. 1679, particularly since one of the principal sponsors of the legislation is Senator Paul Trible from my home State of Virginia. All of us in Virginia who have come to know

Paul Trible over the years are proud of the job he is doing in his new role here in the Senate. We know him to be someone who is knowledgable and sensitive to the problems and needs of rural America.

With your permission, Mr. Chairman, I will submit for the hearing record several documents which will support and amplify the information contained in the statement, including policy resolutions approved by the NRECA membership at their 41st annual meeting earlier this year.

Let me begin if I may by assuring the members of this committee that the NRECA and, I believe, the vast majority of the rural citizens served by our co-op members are in full accord with the fundamental objectives of S. 1679 and agree that top priority must be placed on seeking long-term solutions to our Nation's severe economic crisis.

At the same time, however, rural people are deeply concerned about the future of the REA financing program, a program which has brought about substantial and well-documented social and economic improvements benefiting not only rural areas but the Nation as a whole. When the RE Act was amended in 1973 through Public Law 93-32, the Congress clearly expressed its belief that the power pertaining to established annual loan levels for REA was an adequate mechanism for oversight of the rural electric program and that further controls through the inclusion of these transactions in the unified budget would be unnecessary and redundant.

This is reflected in the RE Act itself, where in no fewer than six different places Congress clearly states its intent that REA loan levels and advances be excluded from the annual Federal budget totals and that these loans not be charged against any statutory or other limitations on the budget, Federal expenditures or debt lending by the Government.

In this light, we believe that the present budgetary regulatory treatment of the Federal Financing Bank transactions with the REA is fully consistent with the provisions of the RE Act and provides Congress and the public with full and complete information on the nature and volume of these transactions.

In addition, we are seriously concerned that a revision of budgetary procedures regarding the FFB could directly or indirectly result in the imposition of new restraints on our access to the Bank, forcing REA and/or its borrowers to seek additional financing directly from the private market. Even with the exemplary record of repayment that has been established by the REA program, there is good reason to wonder, I feel, how Wall Street would respond to a significant and abrupt influx of rural electric borrowings, even with the REA guarantee in place.

Because of this, it is conceivable that some rural electrics would be unable to raise the capital that they need at any price, clearly impacting on the quality of service we can provide to the people of rural America.

The Federal Financing Bank in this sense plays an extremely critical role in rural electrification. This is in addition to the key role it also plays as a mechanism for coordinating the capital market activities of not only REA but a variety of other programs involving guarantees or other types of Federal participation.

Mr. Chairman, let me briefly summarize if I may our principal concerns about several provisions of S. 1679, in its present form. First, we strongly disagree with the idea that guaranteed loans be treated in the budget simply as an outlay, when in fact they simultaneously represent a significant asset to the Government. A more appropriate and, we believe, equitable approach to this would be the implementation of a separate capital budget, which would provide a means to recognize and account for the value of all assets held by our Government, including, of course, long-term notes receivable from REA borrowers.

NRECA has for many years supported the creation of a capital budget for the Federal Government and continues to do so today.

In addition, we are deeply concerned that the language contained in S. 1679 would create significant doubt as to the recourse available to the holder of the REA guarantee should the Secretary of the Treasury make a determination that the guaranteed loan for whatever reason should not be processed through the FFB.

Under existing law, the holder of the guarantee has the discretion to use whatever means of financing is believed to be in the best interests of the consumer member.

Language in S. 1679 could be interpreted, we fear, in such a way as to preclude the holder of the guarantee from considering or pursuing alternatives to FFB for funding these loans.

This would, in our opinion, serve no positive purpose for the Government and could further impede greater use of non-Government financing by those borrowers in the future.

I am aware of the comments made by Senators Domenici and Gorton during the morning session, and I agree that Congress previous to the establishment of the FFB said that loan levels of the Rural Electrification Administration be excluded from the budget totals. Should the Congress wish to change that longstanding public policy, the appropriate way, in our opinion, to do that is consideration of an amendment to the Rural Electrification Act. I commend Senators Domenici and Gorton for their sensitivity on this issue.

In summary, Mr. Chairman, let me say again we applaud this committee's efforts to examine the Nation's economic problems from the credit perspective. We also, however, wish to emphasize our present and continuing accountability to Congress and to point with pride to our responsible record of repayment. Finally, let me say that we welcome any objective review of the rural electric program and its contribution to the productivity of the Nation. Thank you very much for this opportunity to be here.

[The complete statement follows:]

Statement of Guy C. Lewis, Jr. President
National Rural Electric Cooperative Association,
before the
Senate Committee on Banking, Housing and Urban Affairs

Mr. Chairman, and distingushed members of the Banking, Housing and Urban Affairs Committee . . .

My name is Guy C. Lewis, Jr. I am President of the National Rural Electric Cooperative Association, a voluntary national service organization, comprised of nearly 1,000 rural electric cooperatives which operate in 46 states and serve more than 25-million consumer members.

With your permission, Mr. Chairman, I will submit for the hearing record several documents which support and amplify the information contained in this statement, including policy resolutions approved by the NRECA membership at our 41st Annual Meeting earlier this year.

Let me begin, if I may, by assuring the members of this Committee that the NRECA -- and, I believe, the vast majority of the rural citizens served by our co-op members -- are in full accord with the fundamental objectives of S. 1679, and agree that top priority must be placed on seeking long term solutions to our nation's severe economic crisis.

Our consumer-members throughout rural America, many of whom are farmers, ranchers and small businessmen who must use credit to operate, have been especially hard hit by the high interest costs and economic instability of recent years. Rural people are aware of -- and a great many share your concern about -- the degree of influence which Federal activity in the credit markets has on the overall cost and availability of capital, and we applaud your efforts to gain a better understanding in this area.

At the same time, however, rural people are deeply concerned about the future of the REA financing program -- a program which has brought about substantial and well-documented social and economic improvements, benefiting not only rural areas, but the nation as a whole. In this light, then, we feel it is extremely important that the Committee have a full understanding of:

1. How the REA loan program evolved to its present state;

2. The extent to which Congress can -- and does -- exert direct control over the volume and focus of REA lending activities, and;

3. The unique and, we feel, mutually beneficial relationship which now exists among rural electric borrowers, REA, the Federal Financing Bank and the private credit marketplace.

BACKGROUND

Until 1973, REA lending relied on Treasury funds made available for this purpose, in amounts authorized each year by the Congress. These funds were treated in the Federal budget as expenditures rather than loans, with the principal and interest repayments from co-ops going to the U.S. Treasury as general revenues, with no offsetting budgetary credits allocated to the REA program.

To the extent that funds were available in a given year, qualifying borrowers were able to obtain 100% of their capital needs through REA, and except for some variance during the early years of the program, all loans were made at a two percent interest rate. As rural areas began to grow both in population and in their demand for electric energy, however, the gap between the amount of loan funds available and the needs of REA borrowers grew ever wider, resulting in a substantial backlog of loan applications.

In 1973, however, several major changes took place. The REA direct loan program was for all practical purposes terminated. In its stead, Congress created two new REA loan authorities: REA insured loans, designed to meet the capital needs of local rural electric distribution systems, and REA guaranteed loans, meant to make it possible for rural electrics to undertake major construction projects, most often in the generation and transmission areas.

To provide a new funding source for the REA insured loans, Congress in 1973 created a Rural Electric and Telephone Revolving Fund. Originally capitalized with the asset value of REA's outstanding loans, and a small amount of cash in unexpended loan funds, the revolving fund was designed to be largely self-replenishing through the inflow of principal and interest repayments on existing and new REA loans, and by "rolling over" existing notes through the sale of Certificates of Beneficial Ownership (CBOs) in them. Under existing law, these CBOs are sold to the Federal Financing Bank and carry an interest rate equal to the FFB's cost of money plus one-eighth of one percent.

According to the terms of the insured loan program, REA could make loans to qualified borrowers at either a five or two percent interest rate, depending on the individual applicant's consumer density and/or financial strength. Between 1973 and 1981, only a small percentage of these loans were made at the special two percent interest rate. Most were made at the standard five percent rate, and of these, the vast majority covered only 70% of the borrower's total need, thereby requiring the co-op to acquire 30% of its capital from non-REA sources at full market rates. With legislative changes made in 1981, there no longer are any situations in which the use of the two percent interest rate is mandatory, although the Administrator of REA retains the authority to make loans at rates between two and five percent in cases of extreme hardship.

The REA loan guarantee program was also created in 1973, with REA acting as a guarantor and the Federal Financing Bank serving as a conduit for funds acquired by the Treasury in the private capital marketplace. REA borrowers utilizing this program are nearly all power supply cooperatives engaged in the construction and operation of large generating and transmission facilities.

Loans made under the REA guarantee carry an interest rate fully equal to the FFB and Treasury's cost of acquiring these funds, with a one-eighth percent service fee added to cover administrative expenses. Through this fee, the federal government makes a "profit" of some $6-million per year through the placement and servicing of REA guaranteed loans. This income is shown in the budget as general, undesignated revenues to the Treasury.

It's important to note, I believe, that the administration of both programs by REA entails a very well established and effective procedure for evaluating and processing loan applications. For the information of the Committee, I have attached to my statement a review of the key steps in this process. Very briefly, REA puts each application through a rigorous review process which includes strict tests of both the technical and economic feasibility of the project. The efficacy of this aspect of the process is well demonstrated by the fact that in the history of the program there have been only two defaults on loans. Both occurred in the 1940's, and neither involved an operating electric cooperative. The total amount defaulted was $37,237, and there has never been a default of any kind on REA guaranteed loans.

CONGRESSIONAL OVERSIGHT

When the RE Act amendments were enacted in 1973 as Public Law 93-32, the Congress clearly expressed its belief that the power it retained to establish annual loan levels for REA was an adequate mechanism for oversight of the rural electric program and that further controls through the inclusion of these transactions in the unified budget would be unnecessary and redundant. This is reflected in the RE Act itself, where in no fewer than six different places, Congress clearly states its intent that REA loan levels and advances be excluded from the annual Federal budget totals, and that these loans not be charged against any statutory or other limitations on the budget, federal expenditures or net lending by government.

With regard to the insured loan program, Congress sets annual "floor" and "ceiling" levels within which the REA must operate. These limitations are included in the Agriculture and Related Agencies Appropriations bill enacted for each fiscal year, and are based on information provided to the Congress from several key sources. One source is REA itself which, after consultation with the Office of Management and Budget and other agencies, recommends loan activity levels it deems to be appropriate. Another source is the rural electric borrowers themselves, speaking through their national association, NRECA. Specific recommendations are made based on the borrowers own projections of capital needs as determined through an annual loan fund survey. In addition, other interested parties can make their views known to Congress through the hearing process.

A similar procedure is in effect for the REA guaranteed loan program. Here again, Congress reviews the information it receives on projected capital need which it receives from REA, NRECA and other sources, and sets a floor and ceiling limitation on the year's loan guarantees.

An additional measure of control is available through a provision in the law which requires the REA Administrator to provide Congress with no less than 30 days advance notice of his intent to approve a loan guarantee application. The Administrator also is required to provide the Congress with information on the cumulative total of loans approved with each notification of an intended guarantee. In addition, REA must also publish notice in the Federal Register, 30 days in advance of any new guarantee loan commitment.

To change the accounting of Federal Financing Bank transactions without regard for the budget status of the agencies making use of FFB services would, we believe, be in direct conflict with existing provisions of law. This is particularly so in the case of the RE Act, which specifically exempts REA loan levels from the budget totals. We believe that the present budgetary treatment of the Bank's transactions with REA is fully consistent with the provisions of the RE Act, and provides Congress and the public with full and complete information on the nature and volume of these transactions.

In summary, we believe that Congress already has in place a very workable and effective mechanism to closely monitor and control the activity of the REA loan programs. The existing system allows the Congress to fully evaluate the need of the rural electric systems to raise new capital, and balance that need with the current capability of the federal government -- through REA -- to assist in acquiring it.

THE FEDERAL FINANCING BANK'S ROLE IN RURAL ELECTRIFICATION

Rural electric cooperatives, like every other type of utility, have a unique relationship with and responsibility to their consumers. As far as electric power is concerned, consumers have come to expect, and depend upon, the ability of utilities to meet all of their needs.

What this means, insofar as credit demand is concerned, is that unlike many other businesses, the utility industry's need for new capital entails very little discretion. Utilities build new facilities because they must build them to meet their consumers' needs. They must raise the capital needed to build these facilities one way or another when they need it, regardless of how good or bad the credit market may be at that particular time. For most electric utilities, the option of not building the facilities they need is one choice that is not available to them.

Such is the case with the rural electric cooperatives. We borrow for one reason and for one reason only -- to build the facilities needed to provide adequate and reliable service to our member-consumers. Cooperatives borrow from REA to maintain, expand and improve a service which the nation's rural areas cannot do without, and the rural electrics will have to continue to borrow -- one way or another -- to meet these needs in the future.

Because co-op borrowing is largely non-discretionary, reductions in the size and scope of the REA lending programs that might result from ceilings or other overall restrictions placed on FFB activities would have little impact on the actual credit demand of rural electric systems, and -- because the co-ops would by necessity go directly to the private credit marketplace for their needed capital -- would have no discernable impact on the overall credit marketplace.

They would, however, have a significant impact on the cost of that borrowing. Since co-ops are non-profit and all costs necessarily flow-through to the consumer-members, these increased costs would quickly show up in the electric rates rural consumers must pay -- rates which, it should be noted, already average approximately 12% higher than those charged to urban and suburban consumers served by other types of utilities.

In addition, the reliability and quality of utility service provided to rural consumers could be affected also. As non-profit cooperative entities, rural electrics are not at this time well known or understood by a large segment of the investment community. Even with the exemplary record of repayment we have established through the REA program, there's good reason to wonder how Wall Street might respond to a significant and abrupt increase in rural electric borrowings, even with the guarantee in place. Because of this, it's conceivable that some rural electrics would be unable to raise the capital they need at any price.

The FFB, in this sense, plays an extremely critical role, since it is both familiar to and understood by investors. This is in addition, of course, to the key role it always has played as a mechanism for coordinating and timing the capital demands of not only REA, but a variety of other programs involving guarantees or other types of federal participation.

SPECIFIC CONCERNS WITH REGARD TO S. 1679

This Congress and the present Administration have acknowledged the important role of electric energy and the financial plight of the investor owned utility industry by providing them with significant new subsidies through the granting of a broad range of new tax credits and advantages. We are sympathetic to these steps because we are fully aware of the difficulties these utilities have had in recent years in meeting their capital needs. At the same time, however, we are concerned that the legislation before this Committee would handicap the rural electric cooperatives in fulfilling their service obligations.

The following questions arise from language contained in S. 1679 in its present form:

(1) We disagree with the proposed budgetary treatment of guaranteed loans as an outlay when, in fact, they also represent an significant asset to the government.

A more appropriate, and we believe, equitable approach to this issue would be the implementation of a so-called "capital budget" for our government. Under this system, which is used by most business enterprises and a majority of states, budgeting is done in two separate categories: a "current outlays" budget, representing day to day operating expenses, and a "capital budget," which accounts for long term investments and expenditures for land, capital equipment and other items of significant value and longevity. This budget also provides a means to recognize and account for the value of assets held, including, of course, that of long term notes receivable. NRECA has for many years supported the creation of a capital budget for the Federal government and continues to do so today.

(2) We are concerned also that language contained in S. 1679 creates some doubt as to the recourse available to the holder of the REA guarantee should the Secretary of Treasury determine that the guaranteed loan, for whatever reasons, should not be processed through the FFB.

As it now stands, this language could, we fear, be interpreted in such as way as to effectively overturn a decision made by the REA Administrator that a project is qualified for and worthy of an REA guarantee by eliminating any method for exercising that guarantee. Under existing law, the holder of the guarantee has the discretion to use whatever means of financing that is in the best interest of the consumer member. The language in S. 1679 precludes the holder of the guarantee from following this course of action.

Since 1981, the RE Act has stipulated that so long as it is making similar loans, the Federal Financing Bank must process and fund duly approved REA guarantees at the discretion and option of the borrower. This provision gives the electric cooperative the flexibility to arrange financing needed for a project in the manner most advantageous to the consumer.

For a program, which just a few years ago, was threatened with an abrupt and complete termination of its access to the Federal Financing Bank, the so-called "no escape" provision of S. 1679 is, we believe, both unnecessary and needlessly limiting.

To force holders of REA guarantees to make exclusive use of the FFB for the funding of these loans would, we believe, serve no positive purpose for the government or the rural electric consumers, and could, further, be an impediment to greater use of non-governmental financing by these borrowers in the future.

In summary, we fully support efforts to get the nation's economy back on an even course, and applaud this Committee's efforts to examine this problem from the credit perspective. We also, however, emphasize our present and continuing accountability to the Congress, and point with pride to our responsible record of repayment. Finally, we welcome any objective review of the rural electric program and its contribution to the productive capacity of the nation.

Thank you very much for this opportunity to have our views heard.

REVIEW OF LOAN APPLICATIONS BY REA

(1) REA borrower submits loan application packet to REA Operations Field Representative (the local area office). The OFR makes initial determination as to need for financial assistance, ascertains that borrowers eligibility requirements are met, and determines that loan documents are in order prior to forwarding the REA Washington offices;

(2) Loan Applications for insured loans are forwarded to the respective Area Office (Northeast, North Central, Southeast, Southwest, or Western) at REA in Washington. Area Office reviews and separates various segments of packet for analysis by other divisions. Loan applications for guaranteed loans are sent onto Power Supply Division;

(3) Respective segments of packet undergo analysis and review by the Engineering Standards Division, the Environmental & Energy Requirements Division, and the Energy Management and Utilization Division;

(4) Final staff review fo all loan applications is made by the Electric Loans and Management Divison, which re-assembles the various segments of the loan packet, and prepares and gathers any needed supplemental information pertinent to the loan. The division also recommends, to the REA Administrator, whether a loan merits his approval;

(5) The loan packet, complete with any recommendations by the REA staff, is set to USDA's Office of the General Counsel to assure compliance with legal requirements is met;

(6) The loan application packet is forwarded to the Assistant Administrator for consideration; and finally,

(7) To the REA Administrator.

NRECA MEMBERSHIP RESOLUTIONS TO ACCOMPANY THE STATEMENT OF
GUY C. LEWIS, JR, BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

CREDIT BUDGET REVIEW

Legislative changes are being proposed to review annually all federal credit programs and establish a limited credit budget. P.L. 93-32 established a strict procedure for congressional review and authorization of the REA insured and guaranteed loan programs. The congressional appropriations committees annually set a floor and ceiling on REA insured loans. Each loan guarantee is subject to review by Congress 30 days prior to approval, and Congress is also regularly informed of the year's cumulative total.

The comprehensive review of the REA loan program completely meets the Congressional interests in controlling federal credit. Other credit programs should be similarly reviewed and restricted consistent with the increasing Congressional concerns in this area.

We oppose any additional review of the REA program as being redundant and unnecessary.

OFF BUDGET FEDERAL PROGRAMS

We note with some concern the ever-increasing amount of legislation that is being introduced in Congress which would place the Rural Electrification and Telephone Revolving Fund, the Rural Telephone Bank, the Federal Financing Bank and other federal programs in the federal budget.

Since our loan programs have no budgetary authority, require no budgetary outlays and therefore have no impact at all on the budget, we strongly oppose any effort by Congress or any federal agency to place those programs in the federal budget.

FEDERAL FINANCING BANK

The Federal Financing Bank (FFB) has served to coordinate and facilitate government credit activities in an efficient and advantageous manner. It should be continued without change. FFB funding of REA loan guarantees is mutually beneficial to the government and to the borrower. The borrower saves a substantial 150 basis points in interest costs and the FFB makes about $5-million on each year's guarantee program. We commend the Congress for mandating the availability of the FFB funding of REA loan guarantees. We oppose any effort to restrict the FFB participation.

CAPITAL BUDGET

Unlike the budget accounting of corporate businesses and nearly all state governments, the federal government's budget does not differentiate between spending programs and lending or investment programs. A capital budget would greatly enhance the federal budget by treating capital programs as investments and not as expenses, thus increasing the nation's productive capacity and yielding future benefits.

We therefore urge adoption by the Congress and the Administration of a capital budget.

Senator TRIBLE. Mr. Lewis, it is always a pleasure to see you. We are especially pleased to hear you today speaking in your capacity as president for the National Rural Electric Cooperative Association.

REASONS FOR REA TO REMAIN OFFBUDGET

I believe the heart of your statement is the basic contention that REA is offbudget by law and ought to stay that way. Tell us, if you will, why REA should remain offbudget. We know the process of making laws is an ongoing one, and it is true that REA is off budget today. But tell us again for the record, if you will, why in your judgment REA activities should remain offbudget.

Mr. LEWIS. Well, basically, Senator, as I said one time before, I do not think that loans, guaranteed loans, should be treated as outlays of a Government agency, in that they are really an asset and not expenditures.

Also, the off-budget nature of our dealings with the Federal Financing Bank keeps us under the jurisdiction of REA and the Congress, but I am afraid under the proposed legislation we would also have to deal with the Office of Management and Budget. And that I do fear as another restraint on our being able to use the Federal Financing Bank. Our use of it is so vital to the construction of generation and transmission by members of our cooperative that I fear that if we have restraints in that area, we will simply have no source at any price for the type of large amounts of funds that we are expected by our consumers to expend.

Senator TRIBLE. From what I hear you say, it seems that you are saying—at least this is what I hear—that you do not really object to the objectives of this bill, which is to strengthen the budget process, but rather as the spokesman for your important association, you are concerned that your cooperatives need access to funding in order to serve their constituent interests. And any change in the status quo concerns you.

Mr. LEWIS. Yes, sir. I call to your attention the fact that wholesale power from the generation cooperatives as well as the investor owned utilities about 10 years ago was 1 cent per kilowatt-hour. It is now 4.1 cents and 25 percent of that cost is cost of money. It's a big item to us.

Senator TRIBLE. Let me assure you the purpose of this legislation is not in any way to reduce the Federal commitment to your program, but rather to strengthen the budget process and to insure that we have a better accounting of the full force of Government activities.

Now, let me focus on the second reservation you raised toward the end of your testimony. You indicated a concern that all co-ops want to maintain their present flexibility so that they would have the opportunity to use the FFB or go into the private market. Of course, this bill would require the borrower to go to the FFB first for a loan.

Tell me, if you will, exactly what that flexibility has meant to the operation of the FFB. For example, what fraction of REA guarantees have been financed in the private market in the last year or

the last many years, or has the Federal Financing Bank been responsible for those funding activities?

Mr. LEWIS. I am told that only about 10 percent went outside of the Federal Financing Bank.

Senator TRIBLE. 10 percent in the last year? What timeframe are we talking about?

Mr. SMITH. It wouldn't vary that much from year to year, Senator. The Banks of Cooperatives have funded part of some loan guarantees over the last 6 years. I think the total amount of their outstanding funding under the REA guarantees is about—a little over $1 billion. There has been about $15 billion advanced under the loan guarantees. So roughly 10 percent or so has been financed by the Banks of Cooperatives.

They are very concerned that under the provision that the FFB have the right of first refusal, they might not be able to participate as they have in funding the REA loan guarantees.

Senator TRIBLE. My purpose in drafting this legislation is not to foreclose the opportunity to raise dollars in the private sector, but rather to insure that the activities that now proceed through the FFB continue to do so, so that Government agencies cannot end-run the process and thus avoid the budgetary scrutiny that this legislation hopes to bring about.

Mr. LEWIS. May I say, Senator, that I read in the record your reasons for wanting this bill. Let me say again how much we are in favor of your doing just what you are trying to do. We just wanted to make known to you and the committee our concerns that it might affect our program and see if there was anything that could be changed.

Senator TRIBLE. I appreciate your very constructive statement. I might also say that I appreciate the opportunities that we have had to talk about this legislation. And your association should know that you have shared your thoughts and concerns very effectively. So we will continue those conversations in the effort to improve and strengthen the budget process and yet not undercut your important efforts.

I see Senator Sasser is here. He may be holding off his fire until the TVA round.

We welcome you. Would you care to ask questions of Mr. Lewis?

Senator SASSER. Thank you, Mr. Chairman. No, I will forego any questions at this time. I perhaps might have some questions at a later time for the record. Thank you.

Senator TRIBLE. Fine. Thank you very much.

Next we will hear from Charles Dean, Chairman of the Board, Tennessee Valley Authority.

Mr. Dean, welcome.

Senator SASSER. Mr. Chairman, prior to hearing Mr. Dean's testimony, I would like to make a brief statement if the Chair will permit.

Senator TRIBLE. The Senator from Tennessee.

STATEMENT OF JIM SASSER, U.S. SENATOR FROM THE STATE OF TENNESSEE

Senator SASSER. Thank you, Mr. Chairman.

I think it is important that the committee recognize the unique position of Tennessee Valley Authority in the question of the Federal Financing Bank.

There has been a substantial amount of misinformation in the Congress and in the executive branch over the years concerning the uniqueness of the Tennessee Valley Authority, and I want to help clear up some of this confusion before Chairman Dean delivers his testimony today. I am confident that he will clarify the matter in some detail as well.

Mr. Chairman, the Tennessee Valley Authority power program is self-sustaining. In 1959, the Congress passed the Self-Sustaining Act, which has assured that the TVA power program is financed entirely by the ratepayers of the region: not a dime comes from the taxpayers. The TVA power program receives no Federal subsidies in any form and is truly self-sustaining.

Now, the key issue here, I believe, is that under the provisions of the Tennessee Valley Authority Act, the Board of Directors of TVA is charged with responsibility of providing electricity at the lowest possible cost to its customers.

In this regard, TVA, in my opinion, must be provided with continued access to the Federal Financing Bank, as well as access to the private bond market.

Now, it is true that since 1974 TVA borrowing has been primarily from the Federal Financing Bank, but the day may come when borrowing on the private market will provide a lower cost financing mechanism.

So what I am saying is that no legislation reported by this committee should restrict the historical flexibility of the Tennessee Valley Authority's power program.

I have said on many occasions that I oppose any effort to reduce the flexibility of the Tennessee Valley Authority administering its power program in the lowest cost manner. Likewise, I must oppose any legislation that would have an effect, whether intentional or unintentional, which could result in an unwarranted involvement of either the executive branch of the Government or the Congress in the operations of the Tennessee Valley Authority power program.

Certainly, the Congress should continue an effective oversight of all of TVA's programs, and I think I have a long history, as Chairman Dean can attest, as can his predecessor, of holding TVA's feet to the fire on a broad range of issues. I will continue to exercise that responsibility because I think it is a responsibility that a Senator from the Tennessee Valley region who sits on committees of appropriate jurisdiction should exercise.

But I am concerned about the future of the Tennessee Valley Authority. Only 2 years ago, the Reagan administration attempted to deny the TVA access to the Federal Financing Bank, and I opposed that measure successfully, along with my distinguished colleague, Senator Baker.

Likewise, I must oppose a provision which would restrict TVA only to the Federal Financing Bank.

In other words, we must provide the flexibility or maintain the flexibility of TVA to provide the lowest cost electrical power to its customers, as they are required to do by the TVA Act.

So, Mr. Chairman, I thank you for this opportunity to make this brief statement, and I look forward to hearing Chairman Dean's testimony. I welcome him here today, along with the distinguished General Counsel of TVA, and I look forward to working with the committee and insuring that TVA's uniqueness is preserved in any legislation that might become the law.

Senator TRIBLE. Thank you, Senator Sasser.

Chairman Dean.

STATEMENT OF CHARLES H. DEAN, JR., CHAIRMAN OF THE BOARD, TENNESSEE VALLEY AUTHORITY, ACCOMPANIED BY HERBERT S. SANGER, JR., GENERAL COUNSEL

Mr. DEAN. This is Herbert S. Sanger, Jr., General Counsel of the Tennessee Valley Authority.

Mr. Chairman, Senator Sasser, members of the subcommittee, I appreciate the opportunity to be here today to support this subcommittee's efforts to reestablish control over Federal spending and credit programs.

We agree with your remarks upon the introduction of S. 1679, the Honest Budgeting Act of 1983, that some Federal programs are entering into obligations, for which the Nation's taxpayers will be responsible, far beyond the figures actually shown in the unified budget.

We also agree that for Congress to get a better handle on the true scope of these programs and what they mean to future taxpayer liability, the unified budget must become a more accurate measure of taxpayer expenditures and taxpayer obligations.

We understand that the purpose of S. 1679 is to improve the quality of information presented in the unified budget, and this worthy goal has our support.

The bill as currently drafted would, however, unintentionally impose constraints upon the self-financing TVA electric power program, a program that does not involve Government funds and which receives no financial subsidy from the Federal Treasury.

The bill would effectively change the provisions of the 1959 law that placed the TVA power system on a completely self-financing basis.

The essence of the 1959 self-financing amendment was to relieve the Federal Treasury of the burden of financing the TVA power system with appropriations while relieving the power system of the uncertainties of the Federal budgeting and appropriation process.

Two major effects of the bill would be: first, that it could raise the cost of power program borrowings; and second, that it would give the Secretary of the Treasury unwarranted control over power program borrowing activities.

We strongly urge that the relationships between TVA and the Treasury worked out in 1959 and successfully carried out for a quarter century not be changed.

The bill's requirement that all direct agency borrowings and all agency-guaranteed borrowings be first offered to the Federal Financing Bank under Treasury Department regulations poses two problems for TVA.

First, it could prevent the TVA power system from being able to borrow from the public if it were cheaper to do so. For example, if the FFB raises its funds by selling its own securities to the public rather than to the Treasury, its cost of money would probably increase.

In addition, regardless of its source of funds, the FFB has the authority to mark up its funds to borrowers by any amount it chooses.

Second, as mentioned previously, it would give the Secretary of Treasury undue control over TVA's borrowing activities.

Prior to 1959, actions by Government officials were instrumental in preventing TVA from obtaining the capital it needed for building new electric powerplants to keep pace with the growing demands for electric power. The 1959 self-financing amendment was an express repudiation by Congress of this administrative restriction.

The amendment took 4 years to hammer out and established most of TVA's unique financial characteristics. Although the TVA Board always had the responsibility of providing a supply of electric power at the lowest feasible cost, the 1959 amendment delegated to it the exclusive authority to decide how best to finance the power system to meet this responsibility.

This authority is exercised without further executive branch or congressional approvals, within a $30 billion bond ceiling which was established by Congress.

From 1960 to 1974, TVA borrowed the funds it needed from the only source available, the public market. With the creation of FFB, a second source became available at the options of TVA and the Treasury.

In each instance since 1974, TVA has considered the cost of funds from each source and has obtained funds from the source that would cost the electric power consumers the least.

In every instance thus far, the lowest cost source has been the FFB, and we see no reason that this situation should change if the FFB continues its current operating and pricing practices.

We do not have guaranteed access to the FFB, and we seek no guarantee. We borrow from the FFB at the discretion of the Treasury. We do not want the absolute rights or the obligations of FFB borrowings but are glad to continue the status quo using the FFB when it is mutually agreeable.

Should the FFB change its practices or another source of funds become available at a lower cost, TVA should be able to take advantage of that source for the benefit of its electricity consumers. A statutory or administrative prohibition preventing us from doing so would be contrary to TVA's statutory responsibility for making power available at the lowest feasible cost.

Equally as important, giving the Secretary of the Treasury first right of refusal on the purchase of TVA bonds or participation in other financial undertakings would give the Secretary the power to delay the financing TVA needs to conduct its power program for the benefit of its consumers and actual authority, if not outright legal authority, to control the terms and conditions of TVA's borrowings.

After much debate, the 1959 self-financing amendment relegated the role of the Secretary of the Treasury only to the timing of bond issues and the maximum interest rates that such bonds could bear, so as not to interfere with the marketing of the Treasury's own securities. This relationship was preserved later in the FFB Act.

Although section 7(a) of the FFB Act gave the Secretary broad authority over the manner, source, and terms and conditions of the financing of other Federal agencies, TVA was excluded from such additional authority.

The power program must by law charge electric rates that are high enough to meet its obligations and maintain its financial health. One of those obligations is to repay each year to the Treasury part of the taxpayer funds that were originally invested in the power system before 1959.

In addition, each year TVA, with revenues acquired from the consumers of TVA electricity, pays the Treasury a dividend on the outstanding taxpayer investment. Moreover, the amount of the dividend is based on current interest yields, not on the original rates of about 3 percent, at which the money was borrowed from the Federal Government.

These payments to the Treasury for fiscal year 1983 will be more than $126 million.

TVA is also required by law to charge electric rates that are high enough to meet obligations on the bonds it has issued since 1959 to finance the power system.

Before closing, let me emphasize one final point. The TVA power program is unlike any other federally owned undertaking from a financial standpoint. The Federal taxpayers do not back the TVA power program. The power program is entirely self-financing, although all of its assets are owned by the United States.

The TVA power program budget presents the financial activities of the power program each year to Congress for its information and review. The TVA power program is on budget. Nothing is hidden.

Its borrowings are neither obligations nor guaranteed by the United States. Federal courts have absolved the United States of liability where an instrumentality of the United States defaulted on bonds which, like TVA's, were specifically not obligations of the United States, *Bankers Farm Mortgage Company* v. *United States,* 69 F. Supp. 197 (1947).

Although the taxpayers do not back the TVA power program, they do invest in the program in the same way as do private investors. Until 1974, TVA power bonds, always rated as AAA securities, were purchased by private investors. Since 1974, those bonds have been purchased by the FFB.

[The complete statement follows:]

CHARLES H. DEAN, JR.
CHAIRMAN, TENNESSEE VALLEY AUTHORITY
BEFORE THE SUBCOMMITTEE ON FEDERAL CREDIT PROGRAMS
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
SEPTEMBER 19, 1983

S. 1679, "HONEST BUDGETING ACT OF 1983"

Chairman Trible, Senator Sasser, subcommittee members, I appreciate the opportunity to be here today to support this subcommittee's efforts to reestablish control over Federal spending and credit programs. We agree with your remarks upon the introduction of S. 1679, the "Honest Budgeting Act of 1983," that some Federal programs are entering into obligations--for which the Nation's taxpayers will be responsible--far beyond the figures actually shown in the unified budget. We also agree that for Congress to get a better handle on the true scope of these programs and what they mean to future taxpayer liability, the unified budget must become a more accurate measure of taxpayer expenditures and taxpayer obligations. We understand that the purpose of S. 1679 is to improve the quality of information presented in the unified budget, and it has our support.

The bill would, however, unintentionally impose constraints on the self-financing TVA electric power program, a program that does not involve Government funds and which receives no financial subsidy from the

Federal Treasury. The bill would effectively change the provisions of the 1959 law that placed the TVA power system on a completely self-financing basis. The essence of the 1959 Self-Financing Amendment was to relieve the Federal Treasury of the burden of financing the TVA power system with appropriations while relieving the power system of the uncertainties of the Federal budgeting and appropriation process. Two major effects of the bill would be --

1. It could raise the cost of power program borrowings.

2. It would give the Secretary of the Treasury unwarranted control over power program borrowing activities.

We strongly urge that the relationships between TVA and the Treasury worked out in 1959 and successfully carried out for a quarter century not be changed.

The bill's requirement that all direct agency borrowings and all agency guaranteed borrowings be first offered to the Federal Financing Bank under Treasury Department regulations poses two problems for TVA. First, it could prevent the TVA power system from being able to borrow from the public if it were cheaper to do so. For example, if the FFB raises its funds by selling its own securities to the public, rather than to the Treasury, its cost of money will probably increase. In addition, regardless of its source of funds, the FFB has the authority

to "mark up" its funds to borrowers by any amount it chooses. Second, it would give the Secretary of the Treasury undue control over TVA's borrowing activities.

Prior to 1959, actions by Government officials were instrumental in preventing TVA from obtaining all the capital it needed for building new electric powerplants to keep pace with the growing demands for electric power. The 1959 Self-Financing Amendment was an express repudiation by Congress of this administrative restriction. The Amendment took four years to hammer out and established most of TVA's unique financial characteristics. Although the TVA Board always had the responsibility of providing a supply of electric power at the lowest feasible cost, the 1959 Amendment delegated to it the exclusive authority to decide how best to finance the power system to meet this responsibility. This authority is exercised without further executive branch or congressional approvals, within a $30 billion bond ceiling.

From 1960 to 1974 TVA borrowed the funds it needed from the only source available--the public market. With the creation of the FFB a second source became available at the option of the Treasury. In each instance since 1974, TVA has considered the cost of funds from each source and has obtained funds from the source that would cost electric power consumers the least. In every instance thus far, the lowest cost source has been the FFB, and we see no reason that this situation should change if the FFB continues its current operating and pricing practices. We do not have guaranteed access to the FFB and we seek no guarantee. We borrow

from the FFB at the discretion of the Treasury. We do not want the rights or the obligations of FFB borrowings but are glad to continue the status quo using the FFB when it is mutually agreeable.

Should the FFB change its practices or another source of funds become available at a lower cost, TVA should be able to take advantage of that source for the benefit of its electricity consumers. A statutory or administrative prohibition preventing us from doing so would be contrary to TVA's statutory responsibility for making power available at the lowest feasible cost.

Equally as important, giving the Secretary of the Treasury first right of refusal on the purchase of TVA bonds or participation in other financial undertakings would give the Secretary the power to delay the financing TVA needs to conduct its power program for the benefit of its consumers and actual authority, if not outright legal authority, to control the terms and conditions of TVA's borrowings. After much debate, the 1959 Self-Financing Amendment relegated the role of the Secretary of the Treasury only to the timing of bond issues and the maximum interest rates that such bonds could bear so as not to interfere with the marketing of the Treasury's own securities. This relationship was preserved later in the FFB Act. Although section 7(a) of the FFB Act gave the Secretary broad authority over the manner, source, and terms and conditions of the financing of other Federal agencies, TVA was excluded from such additional authority.

The power program must by law charge electric rates that are high enough to meet its obligations and maintain its financial health. One of those obligations is to repay each year to the Treasury part of the taxpayer funds that were originally invested in the power system before 1959. In addition, each year TVA--with revenues acquired from the consumers of TVA electricity--pays the Treasury a dividend on the outstanding taxpayer investment. Moreover, the amount of the dividend is based on current interest yields, not on the original rates of about 3 percent at which that money was borrowed by the Federal Government. These payments to the Treasury for fiscal year 1983 will be more than $126 million. TVA is also required by law to charge electric rates that are high enough to meet obligations on the bonds it has issued since 1959 to finance the power system.

Before closing, let me emphasize one final point. The TVA power program is unlike any other federally owned undertaking from a financial standpoint. The taxpayers do not back the TVA power program. The power program is entirely self-financing, although all of its assets are owned by the United States. The TVA power program budget presents the financial activities of the power program each year to Congress for its information and review. The TVA power program is on-budget. Nothing is hidden.

Its borrowings are neither obligations of nor guaranteed by the United States. Federal courts have absolved the United States of liability where an instrumentality of the United States defaulted on bonds which, like TVA's, were specifically not obligations of the United States. (Bankers Farm Mortgage Co. v. United States, 69 F. Supp. 197 (1947)). Although the taxpayers do not back the TVA power program, they do invest in the program in the same way as do private investors. Until 1974 TVA power bonds--always rated as triple-A securities--were purchased by private investors. Since 1974 those bonds have been purchased by the FFB.

TVA RAISES FUNDS THROUGH FFB OR PRIVATE SECTOR

Senator TRIBLE. We thank you for your statement. When TVA sells notes to the FFB and the proceeds are spent, that transaction is recorded in the agency's budget, and the full impact on Government borrowing needs is recorded in the unified budget. This activity performs a useful service and causes no budget distortions. It obviously should be allowed to continue.

Now, you have expressed a concern today that the provisions of this legislation may compromise your management flexibility of funding by requiring you to turn to the Federal Financing Bank. So let's pursue that, because that is surely not the intention of this legislation.

First of all, for the record, what has been the experience of the TVA in generating the funds that are required? What percentage of the transactions have been routed through the Federal Financing Bank? And what percentage through the private sector?

Mr. DEAN. Since the beginning of 1974, all of our borrowings but for one small issue have been through the FFB.

Mr. SANGER. Prior to 1974, we issued our bonds to the public——

Senator TRIBLE. Since 1974.

Mr. SANGER. The debt outstanding to the public as of 1974 was $1.725 billion. The power program's total debt now is about $14 billion, so we have sold about $12 billion in bonds to the FFB.

Senator TRIBLE. Since 1974, you have always turned to the FFB for your financing requirements?

Mr. SANGER. That's correct.

Senator TRIBLE. Your concern is you want to at least have the flexibility to turn elsewhere?

Mr. DEAN. The 1959 act, which I referred to in my testimony, gave the TVA Board responsibility for raising the funds necessary to build a power system in the manner which would result in the lowest feasible costs for the ratepayers. We'd like to retain the option to select the lowest cost method of financing.

Senator TRIBLE. Under present procedures, TVA can raise money for power operations through the Federal Financing Bank, as you have done since 1974, and those transactions were scored under the budget. Now, under present procedures, if you turned to the private sector, would those transactions appear on the budget as well?

Mr. SANGER. Yes, they would.

Senator TRIBLE. The answer to that question is yes, and that is also the end of the matter, as far as you are concerned.

The objective of this legislation is simply and solely to insure that those transactions, whether they move through the Federal Financing Bank or through the private sector, appear on the budget. They do. Therefore, there is no need to change the present law as it applies to TVA.

Now, on that note, we can go further. But since we have allayed your concerns, we would be happy to hear from you on any other matter. What we had here was an unintended result, a little fish caught in a big net.

The important thing is to insure that the transactions of TVA appear on budget.

Mr. DEAN. I don't mind being a little fish, Senator.

Senator TRIBLE. That is the objective of this legislation.

And with the assurance that the transactions of TVA under present law, whether through the FFB or through the private sector, will appear on the budget, that's the end of the matter as far as this Senator is concerned.

Senator Sasser?

TVA IS SELF-SUSTAINING; NO COST TO TAXPAYERS

Senator SASSER. Mr. Chairman, thank you. I am delighted to hear the chairman's statement, and I applaud it. I would like, for purposes of the record, Mr. Chairman, to go ahead here and get some questions in the record and get response from either Mr. Sanger or Chairman Dean. Chairman Dean, first let me say I thank you for your statement. I think that you described the situation with regard to S. 1679 very accurately. You documented that the TVA power program is self-sustaining, and does not result in any effect on Federal budget outlays. You documented that the TVA power program does not result in any costs to American taxpayers, that the power program of the Tennessee Valley Authority is fully self-sustaining.

Now, I believe there is potential danger in reimposing any Federal constraints on the power program of TVA. We must bring those off-budget entities which impact upon the Federal budget under stricter control, and for that reason, I am generally supportive of the thrust of this legislation.

But clearly, the TVA power program, a completely self-sustaining program, does not impact on Federal budget outlays. Therefore, it's important to preserve the flexibility of TVA in carrying out its power program in accordance with the mandate of the Tennessee Valley Authority Act, which, as we said earlier, requires the Board to provide electrical energy at the lowest possible cost to its customers.

Now, specifically and for the record, how does section 3 or how could section 3 of this legislation give the Secretary of the Treasury control over the TVA power system in a manner contrary to the provisions of the Self-Financing Act of 1959?

Mr. SANGER. Senator, section 3 would require TVA to first offer any debt for sale to the bank, so we could not issue debt until that obligation had been met. It, in effect, gives the FFB a first option of purchasing our debt.

Senator SASSER. In what way would that transmit power to the Secretary of the Treasury that might be detrimental to TVA?

Mr. SANGER. Well, the Secretary of the Treasury in establishing the interest rates at which FFB would loan money to TVA would affect the cost TVA would have to pay for the debt issued.

Also, the Secretary of Treasury, in running the FFB, charges a margin above the Treasury's actual cost of money, and the size of that margin is flexible. Both of these are obvious ways the Secretary could increase the cost to TVA. It's difficult to imagine in advance other ways, but I am sure there could be some.

Senator SASSER. What disturbs me is that some future administration or some future Congress could utilize the provisions of section 3 to establish an unwarranted control over the TVA power

program in a manner which would be detrimental to the citizens of the valley, specifically the customers of Tennessee Valley Authority.

Now, the traditional historical and statutory flexibility of TVA in meeting its financial obligations could be jeopardized by a future administration or a future Congress which does not share the commitment to low-cost, unsubsidized—I want to emphasize that, unsubsidized—public power.

Now, Chairman Dean, or Mr. Sanger, what recommendations do you have to the committee to clarify this concern to prevent such an unintentional interpretation of this legislation should it become law?

Mr. SANGER. Senator, I think a simple way to do it would be to exclude TVA obligations and guarantees from section 3.

The basis for this is, as you pointed out, that TVA obligations are not obligations of the United States, nor are they guaranteed by the United States. And I think consistent with your suggestion and Senator Trible's suggestion that would be the way to do it.

Senator SASSER. While I am concerned that this legislation could unintentionally—I want to emphasize the "unintentional" aspect—result in future political manipulation of the TVA power program, I am also concerned that limiting access of the TVA power program only to the Federal Financing Bank can result at some future date in increased power system costs, and, therefore, artificially increase electric rates to the citizens of the Tennessee Valley area.

I will ask you, Mr. Chairman, if you share that concern, and if you can foresee any circumstances in which borrowing from the private financial market would be cheaper than borrowing from the Federal Financing Bank?

Mr. DEAN. Well, sir, it is of course difficult to foresee everything that might come down the pike. But one example might be if the FFB went to the private market to borrow funds which it now borrows from the Treasury.

Senator SASSER. I think the most critical element of this discussion is the fact that the TVA power program is self-sustaining, and results in no increase in the Federal budget outlays, and it does not increase in any shape, form, or fashion the Federal budget deficit. In the committee reports of the Senate Public Works Committee, when the Congress increased the bonding authority for TVA in 1975, and again in 1979, it was stated explicitly that TVA's bonds do not represent an obligation of the American taxpayer, and do not involve Government funds. The Budget Committee, on which I serve, in its 1975 report took the same position.

The Governmental Affairs Committee, on which I also serve, when we reported the Sunset bill exempted the TVA from provisions of that bill because it stated that the TVA power system funds are not Government funds, which means that they cannot be budget authority or budget outlays, as those terms apply in the Congressional Budget Act.

Congress has repeatedly stated the uniqueness of the TVA power program as being self-financing, and not subject to unwarranted constraint and intrusion.

I ask this final question: To your knowledge, Chairman Dean, or yours, Mr. Sanger, do you know of any committee of Congress that has ever said anything to the contrary, so far as TVA is concerned?

Mr. DEAN. No, sir; we do not.

Mr. SANGER. I think, Senator, you pointed out the three instances where the correct presentation of the TVA power program budget has been specifically described in the way you indicated.

We don't know of any others.

Senator SASSER. Mr. Chairman, you are very kind to allow me the time to make these points, and I think it is important that the point be made as clearly as possible, and repeated, that the TVA power program is self-sustaining. There is a great deal of misunderstanding here in Congress, in the executive branch of the Government—indeed, in the Tennessee Valley area itself—some feeling that this power program is subsidized and sustained by taxpayers' money, and that it does add to the Federal budget deficit, when, indeed, it does not.

And Chairman Dean, I want to thank you for your testimony, and for that of Mr. Sanger, and I look forward to working with you and other members of the TVA board and members of this committee in resolving this matter in a way which protects the ratepayers and assures the flexibility of the Tennessee Valley Authority regarding the power program.

I encourage the statements that our chairman, Senator Trible, has made today.

Senator TRIBLE. Thank you, Senator Sasser. I will be able, now, to put this matter in perspective, as I understand it.

Our discussion this afternoon, gentlemen, has focused on TVA's broader requirements. Senator Sasser has made the point that the power program is self-sustaining. It does not depend on the Federal Government. It is my view that the provisions of this bill should not apply to TVA in terms of its own borrowing requirements, and I think that's the point that you have tried to make here today.

Now, it is my view, however, that the provisions of this bill should apply to TVA loan guarantees. TVA loan guarantees that use the Federal Financing Bank become off-budget loans, and they do have a very direct impact on the operation of the Federal Government, on the spending and borrowing requirements of the Federal Government. Now, surely, those transactions should be reported in the budget, and I want to make that point clearly here today, because you said nothing about that.

Your focus has been on the financing requirements of TVA. I think your point there is well taken. Those transactions, whether they are pursued through the Federal Financing Bank or through the private sector, are scored today and therefore there is no need to bring you under the provisions of this legislation as it applies to those kinds of transactions.

Thank you very much, gentlemen. We are pleased that you were here.

Mr. DEAN. Thank you, Senator.

[Response to additional questions from Senator Sasser follows:]

QUESTIONS BY SENATOR SASSER

Senator Sasser: Your testimony explains how section 3 of S. 1679 would give the Secretary of the Treasury control over TVA power system financing. Section 2 of the bill is intended to change the way in which FFB transactions are shown in the budget. How would section 2 affect the TVA power system budget?

Mr. Dean: Direct TVA borrowings, as you indicated, are now and have in the past been shown on the budget. These borrowings, as you also stated, are not obligations of the Federal Government--they do not involve Government funds and do not represent obligations of the American taxpayer. Section 2 would statutorily require that TVA financing through the FFB--both direct borrowings from the FFB and indirect financing through TVA's nuclear fuel lease with the Seven States Energy Corporation--be shown as obligations which will result in immediate or future outlays of Government funds. As Senator Trible stated, "The objective of this legislation is simply and solely to ensure that those transactions (TVA and other borrowings), whether they move through the Federal Financing Bank or through the private sector, appear on the budget. They (TVA's borrowings) do. Therefore,

there is no need to change the law as it applies to TVA." This statement is consistent with the three committee statements to which you referred as describing how the TVA power program should be shown in the Federal budget. I should note that OMB has views about this which differ from TVA's.

Senator Sasser: What is the purpose of the Seven States transactions?

Mr. Dean: Since 1979, all of TVA's nuclear fuel has been owned by the Seven States Energy Corporation, a wholly owned subsidiary of a California banking corporation. Seven States leases the fuel back to TVA when it is needed in a nuclear power plant. In the meantime, Seven States finances the stockpile of fuel it owns by borrowing from the FFB on the basis of its lease arrangement with TVA, which the FFB regards as a guarantee for these loans.

The process of mining, milling, and enriching uranium and fabricating nuclear fuel takes several years. The purpose of the nuclear fuel lease with Seven States is to postpone putting any of these costs into electric rates until the fuel is actually created and used.

This kind of arrangement is common among electric utilities. At first, we planned to have this nuclear fuel arrangement financed in the private financial market. It was the FFB that requested the financing be handled through it, and it helped create the present arrangements.

Senator Sasser: You have said that the financial transactions of TVA's power system are on-budget, but don't TVA's arrangements with the Seven States Energy Corporation have the effect of moving some of these transactions off-budget?

Mr. Dean: TVA is responsible for this debt just as it is responsible for its direct borrowing. The obligation is TVA's, not the American taxpayer's, and it should be treated the same as TVA's direct borrowings. I should note that OMB has views about this which differ from TVA's.

Senator Sasser: Still, Mr. Dean, when I look at the budget's listing of Federal credit transactions handled through the Federal Financing Bank, it strikes me that Seven States is the largest user of FFB credit. Why is this?

Mr. Dean: The figure listed as "budget authority" in the Budget for FY 84 is 34 times larger than the actual level of FFB's lending to Seven States. It thus appears that Seven States is utilizing more than 26 percent of the FFB's total activities. However, loans to Seven States are actually less than 2 percent of the total FFB credit budget. The discrepancy is caused by an accounting practice used in the Budget that measures only gross transactions. Let me explain.

At the end of FY 83, Seven States will have borrowed about $1.4 billion from the FFB. This level is expected to increase to about $1.6 billion by the end of FY 84--making about $200 million of additional borrowings during FY 84. However, the Budget lists the Seven States transactions for FY 84 as $6.3 billion in "budget authority." Seven States borrows from the FFB with 90-day notes. This means that every 90 days--four times each year--the entire outstanding debt is rolled over. Each time it is rolled over, it is counted again for Budget purposes even though it remains the same debt.

We are pleased that according to OMB and the Congressional Budget Office this overstatement of the Seven States transactions will be corrected. The staff of the Federal Credit Subcommittee played a major role in bringing this about, and we appreciate it.

Senator TRIBLE. Next we will hear from Ron Utt, deputy chief economist, U.S. Chamber of Commerce.

Dr. Utt, welcome. We're pleased to have you here with us today.

STATEMENT OF RON UTT, DEPUTY CHIEF ECONOMIST, U.S. CHAMBER OF COMMERCE

Dr. UTT. Thank you, Senator, and thank you for the opportunity to present the chamber's views.

Senator TRIBLE. Dr. Utt, your statement will be made part of the record. We invite you to read your statement or summarize it, as you wish.

Dr. UTT. I am Dr. Ronald Utt, deputy chief economist for the U.S. Chamber of Commerce on whose behalf I am testifying today. I welcome this opportunity to present our views on S. 1679, which would amend the Federal Financing Bank Act by requiring that loans and agency debt financed through the FFB to be included in the unified budget. I would also like to commend the committee for recognizing the urgent need to develop better budgetary control over the massive array of Federal credit programs that now account for more than 20 percent of the funds advanced in U.S. credit markets.

My written statement which has been submitted to the committee details the magnitude of this vast array of programs, and it discusses the many adverse effects that these programs create in our economy. In the interest of time, I will not repeat these issues in my opening statement and request that this statement be submitted for the record.

For now, I would like to focus my remarks on the legislation under consideration and on the other proposals that the chamber recommends for improving congressional control over the credit programs.

Following several years of careful consideration and review of these programs, their economic impacts and the institutional arrangements and budgetary procedures that influence their growth, the chamber recommends the enactment and/or implementation of five key proposals we believe will make an important contribution to reforming the Federal loan programs and limiting their future growth.

First we recommend enactment of S. 1679. In the past we have had some concerns about combining Federal credit advances, including loans and loan guarantees, with the current expenditures which now comprise the bulk of the unified budget, preferring instead the establishment of two separate budgets, one for expenditures and one for credit advances, and subjecting both to the discipline of the budget process. However, recent experience with binding credit budgets and the continuing propensity of Government to give certain activities an off-budget status, has made it clear to us that a more effective control mechanism is needed.

S. 1679 offers such a mechanism for those credit programs that would be subject to its scope. By bringing many of these programs onto the budget and into the mainstream of the budget debate, these programs will no longer be cloaked in the obscurity that has aided and abetted their rapid growth over the past 7 years.

With each dollar of net lending contributing a dollar to the highly visible unified budget deficit, there is a greater likelihood that firmer limits will be placed on credit programs in an effort to reduce the deficit. Furthermore, by bringing the FFB's lending activities onto the budget and by requiring that these loans be reflected in the deficit, the unified budget will provide a more accurate picture of the extent to which these activities absorb and reallocate the Nation's scarce resources.

As important as this step would be, this committee should recognize that many more legislative initiatives will be required to come to grips with the problem of rapid credit growth. There are two reasons for this.

First, inclusion in the unified budget is no guarantee that growth in credit programs will be restrained. As long as many of these programs maintain their entitlement status and continue to offer very attractive subsidized rates to program beneficiaries, control problems will persist.

In the absence of other forms of restraint, control proposals that rely chiefly on better accountability, honest budgeting, and aggregate targets will not necessarily be effective in controlling program growth for the same reason that the spending entitlements continue to slip past the elaborate and comprehensive controls and accountabilities of the existing congressional budget process. Second, because only a portion of the Federal Government's credit activities are funded by the FFB, control procedures which encompass all credit activities are also needed.

For this reason, the chamber continues to endorse legislation that would establish a formal, permanent credit budget that subjects all loans and loan guarantees to the discipline of the budget. With a formal credit budget, Congress would have to set an overall credit target consistent with general macroeconomic policy objectives, trends in the budget deficit and the state of domestic financial markets.

Once such an upper limit on total credit support is established, Congress would be required to allocate this fixed total among competing uses. This would necessitate scrutiny of each of the many credit programs. In turn, this evaluation process could lead to program reforms, as well as to the elimination of duplicative programs and those that have outlived their usefulness.

ADDITIONAL PROPOSALS OFFERED BY CHAMBER OF COMMERCE

In addition to our support of S. 1679 and legislation that would establish a credit budget, the chamber also recommends that Congress consider the development and/or the enactment of the following additional proposals.

In order to facilitate an effective evaluation process, our third recommendation is that Congress develop a clear and concise criteria that could be used to reassess each of the existing programs and to better relate the objectives of the program with the type of credit assistance that is offered.

In surveying the 350-some odd programs, it is obvious that they represent a 50-year accumulation of overlapping activities without any clear sense of priorities regarding either the level of support,

the depth of support or the type of support. Interest rate subsidies, for example, vary widely and appear to have little relationship to current national objectives.

Development of a criteria for granting credit support should be able to assist us in answering questions such as, what are the beneficiaries' credit problems—access or ability to pay? Is the existing interest rate subsidy appropriate in light of the changed financial market conditions? Are the programs equitable? Has the original program objective been met? Where an interest rate subsidy was once offered, will a guarantee be sufficient now?

Given the vast scope and complexity of the Government's credit market involvement, such criteria will be essential to making informed decisions on the needs for existing and proposed credit programs?

Our fourth recommendation is to limit interest rate subsidies on direct loans and on guaranteed loans that are converted into direct loans. Many program interest rates were set by statute in the distant past when market rates were much lower. Programs that once offered modest subsidies now offer deep ones. The failure to change these rates in response to changed market conditions has contributed both to rising program costs and excessive program demand.

Finally, we urge that in reviewing the existing programs, Congress consider modification, reduction or elimination of those programs and program objectives that can now be met by private sector sources. Many Federal credit programs have provided important benefits to our economy by either demonstrating the commercial viability of a certain type of loan or enterprise, or by providing credit for important segments of our economy when financial and economic stress immobilized the private financial system. But as times change, the initial justification for establishing the program may no longer exist.

In conclusion, the chamber believes that the reforms included in S. 1679, the establishment of a formal credit budget and the three additional proposals discussed in our statement would make an important contribution to limiting the growth in Federal credit programs.

We urge this committee to carefully consider these proposals and recommend that Congress enact the appropriate legislation to put them in place.

[The complete statement follows:]

26-196 O—83——9

Statement of the Chamber of Commerce of the United States

ON: AMENDMENTS TO FEDERAL FINANCING BANK

TO: SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE

BY: DR. RONALD D. UTT

DATE: SEPTEMBER 19, 1983

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The Chamber of Commerce of the United States is the largest federation of business and professional organizations in the world, and is the principal spokesman for the American business community. The U.S. Chamber represents more than 207,000 members, of which more than 203,000 are business firms, more than 2,600 are state and local chambers of commerce, and more than 1,200 are trade and professional associations.

More than 85 percent of the Chamber's members are small business firms having fewer than 100 employees. Yet, virtually all of the nation's largest industrial and business concerns are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the U.S. Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance -- numbers more than 15,000 members in the U.S. Chamber. Yet no one group constitutes as much as 23 percent of the total Chamber membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity and not a threat. In addition to the 47 American Chambers of Commerce Abroad, an increasing number of Chamber members are engaged in the export and import of both goods and services, and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

STATEMENT
on
AMENDMENTS TO FEDERAL FINANCING BANK
before the
SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
Dr. Ronald D. Utt
September 19, 1983

I am Dr. Ronald D. Utt, Deputy Chief Economist for Economic Policy at the Chamber of Commerce of the United States. On behalf of the Chamber's over 207,000 business, trade association and local and state chamber members, I welcome this opportunity to present our views on federal credit programs, their rapid growth in recent years, and the existing and proposed efforts to control them, including S. 1679, a bill that would require that programs financed through the Federal Financing Bank (FFB) be included in the federal budget.

The Chamber endorses S. 1679, enactment of which would be an important step toward gaining better control over those portions of the federal credit programs that are ultimately financed by the FFB. However, by itself, inclusion of these programs in the budget is no guarantee that such a control mechanism will be effective or that program growth will be limited.

The need for better control is obvious. Since the late 1970s, federal loan and loan guarantee programs have expanded at a rate in excess of the direct federal spending. As a consequence, federal credit program activity has risen to record levels of intrusion in U.S. financial markets, leading to an unprecedented degree of government credit allocation. Combined with the borrowing needed to fund the deficit, total funds raised under federal auspices absorbed nearly 50 percent of all funds raised in credit markets.

Given the current state of our financial markets, the expectation of continued large budget deficits and the private sector's need for investment capital, the Committee is to be commended for focusing its attention on this important but often ignored aspect of federal credit market intrusion.

Typically, concern for the extent to which the federal government "crowds out" private borrowers has been expressed solely in terms of the size of the budget deficit. The deficit does, of course, interfere with financial markets, but it is only one aspect of federal credit pre-emption, because it does not reflect the activities of the loan and loan guarantee programs of federal agencies and federally-sponsored enterprises. Indeed, in fiscal years 1980 and 1981, these programs pre-empted an even greater share of domestic credit resources than did the budget deficit.

Scope of the Federal Credit Control Problem

Defined as direct loans and loans guaranteed by federal agencies and federally-sponsored entities, these lending programs have exhibited all of the growth and control problems usually attributed to federal spending. In recent years, these loans and loan guarantees have grown at a much faster rate than have the more widely considered measure of budget outlays. From 1976 through 1983, budget outlays rose 122 percent, compared to 387 percent for net federal loans and loan guarantees and federally-sponsored credit advances.

Compared to the attention devoted to the deficit, the relative neglect of this lending activity is rather surprising inasmuch as these programs have essentially the same effect on our economy and its financial markets as does the more visible deficit. Both lay claim to scarce domestic resources and reallocate them to a vast array of beneficiaries. Moreover, these programs are not negligible in size. During FY 1982, the federal government and its sponsored enterprises made $182.8 billion in loans to various private and quasi-private entities, and guaranteed another $85.8 billion in loans, for a total of $267.6 billion in federal credit market intervention. After netting out repayments and double counting, net new lending and guarantee support reached $87.5 billion in FY 1982.

As a result of the recent rapid growth in these programs, federal lending activities in the first three years of this decade accounted for more than 20 percent of total funds advanced in U.S. credit markets, up from 17.1 percent in FY 1979 and 11.9 percent in FY 1977. When the borrowing needed to fund the deficit is added to this, total government credit demands amounted to 48.9 percent of all funds raised in U.S. credit markets during FY 1982.

In large part, the size of the lending activity and the rapid growth of the programs are attributable to the special attractiveness of these programs to the eligible borrowers and to the government officials who create, enact and administer them. The borrowers like the programs because they offer loans at interest rates that are often substantially below market rates, with rates of 2 percent, 5 percent or 7 percent not uncommon. The Office of Management and Budget estimates that the present value of the interest rate subsidies available on federal loans made during FY 1982 amounted to between $10.8 and $14.0 billion, depending upon market interest rate assumptions. In FY 1980, when market interest rates were higher, the value of the subsidy was estimated at $18.8 billion.

Public officials like the programs because they offer a way of assisting constituent groups without adding to budget outlays and the reported deficit. Moreover, the funding of these programs does not necessarily require any increase in tax revenues. Of the $87 billion of net new loan support provided in FY 1982, only $9.1 billion appeared on the budget. The remainder stayed off budget, either through a variety of creative accounting techniques or because the program's authorizing legislation specifically stated that the program will not be included in the budget. The FFB, a major source of funding for many of the loan programs, is off budget by statute. By the end of this fiscal year, the FFB's holdings of agency debt and loans is expected to total $140.9 billion.

The practice of giving these loan programs an off budget status has contributed to their rapid growth by removing them from the close scrutiny of the budget process and from the view of a public that is deeply concerned about the deficit as reported by present federal accounting procedures.

The growth of these programs and the apparent lack of an effective mechanism to control them as well as an apparent absence of collective congressional will to limit their growth is particularly alarming in light of this country's widely-acknowledged capital formation problem and the effect this has had on our productivity, standard of living and international competitiveness. Given this concern for investment, it is unfortunate that the continued neglect of these lending programs has allowed them to grow to the point where they pose a threat to capital formation.

Since private business capital formation depends heavily on the cost and availability of credit, public policies that raise costs, limit supply and misallocate scarce resources will diminish the amount of private capital formation that is undertaken. These credit programs, by pre-empting a significant portion of the credit pool, reduce the amount of funds available to the private business sector as well as to the consumer who must compete with the government for credit to purchase a home or an automobile.

Further, the interest rate subsidies that usually come with these federal loans contribute to an inefficient allocation of credit within our economy. At a time when high interest rates have forced businesses to limit their investment and to direct their funds only to those projects that offer the promise of very high yields, federally-assisted borrowers, paying subsidized interest rates, are able to invest in projects whose return may be only a third or a fourth of that required by private business. As a consequence, the productivity of our capital stock is lowered and economic growth and output suffer accordingly.

In addition to their adverse impact upon the nation's efficient use of its scarce capital resources, the operation of these lending programs has often been wholly out of phase with major macroeconomic policy initiatives. During 1980, efforts to reduce the rate of inflation were the primary focus of government policies, and heavy reliance was placed upon the Federal Reserve to meet that objective by slowing the growth of overall credit extensions. As the record clearly shows, the Fed was successful in achieving that objective. The amount of total credit advanced in the U.S. economy actually fell by 14.1 percent in FY 1980 and 4.3 percent in FY 1982.

But while the private sector was forced to make do with less, the federal lending programs and the recipients of their many loans and loan guarantees not only remained unscathed but managed to increase their share of the credit pie. In fact, the net volume of credit advanced under federal auspices actually increased over the period. Thus, while one segment of government was taking harsh measures to reduce inflation, the actions of other government agencies offset these efforts. As a result, the unassisted sector bore a disproportionate burden of monetary restraint. In 1980, when a 20 percent prime rate and 16 percent consumer loan rate contributed to the failure of approximately 1,600 automobile dealerships, the Rural

Electrification Administration began a new program to provide 35 year loans at a 5 percent interest rate to finance rural cable television systems.

Past Efforts to Control Federal Credit

In recent years, there has evolved in public policy circles an increased awareness of the problems created by the rapid growth in these programs. This recognition of the problem has led to the development of a number of proposals designed to exert some sort of control over federal lending. President Carter's 1980 budget expressed concern over this growth and announced the implementation of a control system based on annual limitations on gross lending activities. In his 1981 budget, a credit budget was introduced and loan and loan guarantee targets were set for the next fiscal year. In order to offset the excessive growth in the past, the President's budget for that year proposed that direct loan obligations should increase by only 1.7 percent and that growth in loan guarantee commitments should be held to 8.3 percent. But by the time his 1982 budget was published, it was apparent that the new control system was slipping badly and that 1981 federal credit growth would increase significantly. During that year, outstanding direct loans grew by 21 percent while outstanding guaranteed loans increased by 15 percent.

The failure to stem the growth in federal credit is not especially surprising inasmuch as the Carter budget proposed to subject only a portion of the credit programs to appropriation bill limitations. Of the $60.7 billion in new direct loan obligations, only half ($27.2 billion) were to be subject to appropriations bills. Of the expected $81.4 billion in proposed loan guarantees, limits were set on only $32.5 billion, or three-fifths of the total.

In discussing these proposed limits, the FY 1981 budget noted a key obstacle to controlling the credit programs (and spending programs as well) that is as true today as it was then.

> "At this stage in the development of the credit control system, the administration is proposing that certain credit programs be subject only to the control provided by authorizing legislation. Appropriation bill limitations have not been proposed for these programs, which include insurance programs...and entitlement programs, under which qualified

> recipients have a legal right to direct loans or loan guarantees. These are analogous to relatively uncontrollable outlays in the regular budget and comprise a large portion of federal credit activity."

The fact that many of the credit programs are of an entitlement nature is one of the chief reasons why we believe that proposals such as S. 1679 represent only a partial solution to the problem of rapid federal loan and loan guarantee growth. As long as certain individuals are entitled by law to receive loans and loan guarantees, control proposals that rely chiefly on better accountability, honest budgeting and aggregate targets will not necessarily be effective in controlling program growth for the same reasons that the spending entitlements continue to slip past the elaborate and comprehensive controls and accountabilities that comprise the existing budget process.

Recognizing that the unusual budgetary status of many of these programs was partly to blame for their apparent uncontrollability, a number of proposals have been introduced during the past few years to establish a formal mechanism to better control federal credit programs. Reps. Mineta and Bethune and Senator Percy introduced legislation that would have the effect of formally including all federal credit activities, regardless of current budget status, in the congressional budget process. Under their proposals, Congress would create a credit budget that would establish formal limits on total federal lending support for each fiscal year. In effect, Congress would follow the same budget process for loans and guarantees as is currently mandated for revenues and spending. With the total established at the outset, Congress would have to allocate this fixed amount among competing federal programs according to a clearer sense of national priorities. The Chamber endorsed these two bills and recommended their enactment.

Although neither of the bills were enacted, Congress has, through the budget resolutions for FY 1983 and FY 1984, established a formal, binding credit budget for the fiscal year under consideration and subjected the credit programs to the existing budget process. In effect, Congress would, on a year-to-year basis, follow the same budget process for lending as is currently mandated for revenues and spending.

This process of temporary, one year credit budget authority offers some insights into how a permanent credit budget might work. The first observation

is that Congress initially passed up an opportunity to establish ceilings that would actually restrain credit activity. Initially, ceilings were set at levels equivalent to a current services estimate of what credit support would have been in the absence of any overall restraint mechanism. In FY 1982, when ceilings were not binding, credit limits were set well above actual loan activity. In establishing the binding FY 1983 ceilings, Congress left the ceilings essentially unchanged for direct loans and secondary loan guarantees, and raised the ceiling for primary loan guarantees by 36 percent. Since actual FY 1982 activity fell well below that year's ceilings, the FY 1983 ceilings would have allowed for a substantial expansion in actual credit activity.

For FY 1984, the First Budget Resolution held the line on all guarantees and reduced the ceiling on direct loan obligations. If these ceilings hold, and if the process of restraint continues, over time the federal credit programs should decline as a share of total credit advanced in the U.S. economy.

The second observation, which has relevance to the legislation before this committee, is that the credit budget has yet to attract a great deal of public and congressional attention. Unlike the federal budget, which is the subject of intense debate, scrutiny and wide attention, the credit budget often becomes a mere footnote to the larger issue of federal budgeting and resource allocation between the private and public sectors. Without such scrutiny, and without the ever present threat that program expansion will add to the highly visible budget deficit, expensive credit programs of limited value will continue to exist and grow.

S. 1679 will alter this by effectively bringing many of these programs on to the budget and into the mainstream of the budget debate. No longer will these programs be cloaked in obscurity. With each dollar of net lending contributing a dollar to the reported deficit, there is a greater likelihood that firmer limits will be placed on credit programs in an effort to reduce the deficit.

Chamber Recommendations to Control Federal Credit

While the one-year credit budget authority combined with past and present efforts by this Administration may have had some success in limiting

the growth of federal credit programs, it is imperative that a permanent, comprehensive and highly visible set of processes and procedures be adopted to ensure that these programs come under scrutiny every year and that firm limits, consistent with an efficient allocation of credit between the private and the public sectors and long-run growth objectives, are set on federal credit activities.

As trends over the past several years demonstrate, informal targets and good intentions have not been very effective in restraining these programs in the face of substantial demand for subsidized loans and loan guarantees. A more formal and binding process is required if we are to restore a better balance between private and public credit needs.

It is for this reason that the U.S. Chamber endorses the proposed changes to the Federal Financing Bank Act of 1973 that are contained in S. 1679. By bringing the FFB's lending on to the budget and requiring that these loans be reflected in the deficit, S. 1679 will provide a more accurate picture of the extent to which these activities absorb and reallocate the nation's resources. Moreover, by moving these activities from their off-budget status on to the budget, future efforts to limit their growth are likely to be more successful.

As important as this step would be, many more legislative initiatives will be needed if we are to come to grips with the problem of rapid federal credit growth. Because only a portion of the federal government's credit activities are funded by the FFB, control procedures which encompass all credit activities are also needed. For this reason, the Chamber continues to endorse legislation that would establish a formal, permanent credit budget that subjects all loans and loan guarantees to the discipline of the budget process. With a formal credit budget, Congress would have to set an overall credit target consistent with general macroeconomic objectives, trends in the budget deficit and the state of the domestic financial markets. This process could also be used to lower gradually federal credit intrusion in domestic credit markets to the 14 percent it averaged during the decade of the 1970s.

Once such an upper limit on total credit support is established, Congress would be required to allocate this fixed total among competing uses. This would necessitate scrutiny of each of the many loan support programs. In

turn, this evaluative process could lead to program reforms, as well as the elimination of duplicative programs and those that have outlived their usefulness.

In addition to our support for S. 1679 and legislation that would establish a credit budget, the Chamber also recommends that Congress consider the development and/or enactment of the following proposals.

Establish Criteria for Granting Federal Credit Support

In order to evaluate effectively the extensive collection of federal credit programs, it is imperative that Congress have a clear and concise criteria to apply to each program when considering whether the program should be continued as is, reformed, reduced or eliminated. Given the different basic forms of credit support that are offered and the many different reasons why programs have been established, such a criteria would be a valuable tool for reforming the credit programs and establishing better control over their growth.

As a starting point, I would observe that credit programs have been established for three basic reasons:

(a) To overcome imperfections in credit markets. Such imperfections include inadequate private credit facilities and/or an overestimation of loan risk by private lenders.

(b) To overcome a divergence between an investment's private and social returns. In some cases, a project may have important benefits to society while yielding only modest returns to a private investor.

(c) To compensate for the inadequate incomes of potential loan recipients. Individuals or communities with low to moderate incomes may be denied access to needed credit because of an inability to carry the debt service charges at market interest rates.

In the case of (a), loan guarantees or direct loans at market interest rates would be the appropriate form of federal credit assistance. In the case of (b) and (c), some form of interest rate subsidy may be offered in conjunction with either a direct loan or loan guarantee.

The categorization of programs by the above criteria or some similar set of objectives would be a useful starting point for evaluating the government's diverse credit activities. Once this is done, programs within categories could be more easily compared and subsidies better evaluated.

Limit the Interest Rate Subsidies Available on Direct Loan Programs

A review of Tables F-14a and F-14b of Special Analysis F of the budget indicates that the interest rate subsidies on some programs are quite deep and that the dollar costs of these subsidies are expensive in terms of present and future budget outlays. In the case of many of these programs, the interest rates were set by statute at a time when market interest rates were much lower. As market interest rates increased over time, programs that once received modest subsidies now receive deep ones. As a consequence, the demands for these loans increased sharply as more and more individuals attempt to take advantage of the generous federal subsidies. The rapid growth in the student loan program during the late 1970s and early 1980s is an example of this. As long as interest rates on federal loans are below market rates, these credit programs will remain popular and constituent pressure will make it difficult to limit their growth, regardless of how they are treated in the budget.

The establishment of a minimum federal lending rate might be a solution to this problem. Further, this Committee might also consider altering the so-called "unsubsidized" rates on direct loans funded by the FFB by lending at a rate comparable to what private borrowers pay rather than what the federal government pays. While the government does make a profit on these loans, the loan recipients often receive a loan at a rate below comparable market interest rates.

Reform or Limit Programs When there are Adequate Sources of Funds from Private Sector Lenders

Many federal credit programs have provided important benefits to our economy by either demonstrating the commercial viability of a certain type of loan or enterprise, or by providing credit for important segments of our economy at a time when financial and economic stress immobilized the private financial system. But as times change, the initial justification for

establishing the program may no longer be valid. When private sector sources are available to meet the needs of current program recipients, consideration should be given to modifying, reducing or eliminating those federal credit programs that compete directly with private sector lenders.

Relevance of Proposals to an Existing Federal Credit Program

Having listed and discussed these proposals, a useful exercise in evaluating their appropriateness would be to relate them to an existing credit program that relies heavily on the FFB for funds. For purposes of this exercise, the Rural Electrification Administration (REA) is selected, largely because it was recently evaluated by the Office of the Inspector General, U.S. Department of Agriculture, and because nearly 20 percent of the total FFB new lending in FY 1982 went to fund REA activity, according to a CBO study on federal credit.

The original purpose of the REA was to provide the necessary capital to extend electric service to rural areas that had not been electrified by the private utility industry. The REA Act authorizes loans for the purpose of financing the construction and operation of generating, transmission, and distribution systems for furnishing electric energy to persons in rural areas.

The Inspector General's Audit Report focuses on REA's operation of the revolving fund, policies and procedures for making and disbursing insured loans to cooperatives, and the cooperatives' use of such loan funds. The report discovered that the financial condition of the revolving fund is deteriorating rapidly, due to the growing disparity between incomes and expenses. It will eventually require congressional appropriations unless interest rates can be increased and loan criteria changed.

The problems uncovered by the Audit Report on REA, which relate to the general problems of federal credit discussed in our statement and to the recommended reforms, are as follows:

1. Because REA is required by law to limit interest rates to 5 percent on loans made from the revolving fund, and because the cost of government borrowing over the past ten years has significantly exceeded those rates, REA has begun selling the fund's assets to finance the program. By 1985, REA's interest expense will exceed interest income. Unless

interest rates charged to borrowers are increased to reflect the cost of government borrowing, REA will have to seek Congressional appropriations to subsidize the fund. This subsidy would be in addition to the $307 million a year in subsidies presently obtained by the REA by interest-free notes to the U.S. Treasury.

2. REA has interpreted the Rural Electrification Act and Congressional directives to allow loans to be made to cooperatives regardless of their financial strength or the urban/rural characteristics of their service areas. Consequently, REA continues to provide loans to borrowers whose service areas are no longer rural, as defined in the Act, and to borrowers who are financially sound and could obtain credit from other sources.

3. The Audit Report and a prior General Accounting Office (GAO) report conclude that many cooperatives could obtain outside financing at higher interest rates without a significant adverse effect to rural electric users. The Report selected 50 cooperatives which appeared to be financially sound to determine if their financial positions were similar to those of neighboring investor-owned or municipal systems. It found that 44 of the cooperatives were in a stronger financial position than neighboring investor-owned or municipal utilities providing similar services. The report then analyzed what effect higher interest costs would have on 37 of the 50 cooperatives. The results of the analysis showed that the increased costs associated with the higher U.S. Treasury rate did not have a significant impact on the retail electric rates of distribution cooperatives. According to the analysis, 17 of the 37 cooperatives had lower retail electric rates than the comparable investor-owned utilities, both before and after adjustment for the higher costs. Furthermore, of the 12 cooperatives whose rates were higher, but within 10 percent of the neighboring utilities before adjustment, 11 remained in that category.

4. The Report's judgment sample of 38 cooperatives located within 50 miles of a large urban center disclosed 34 whose service areas were no longer entirely rural. A review of 9 of the 34 revealed that they were primarily serving the suburban residents of major metropolitan areas.

Thus, as the government's own study indicates, there is reason to believe that many of these credit programs are no longer serving their original purpose, and that they are providing assistance and subsidies to entities that are capable of obtaining their credit resources from the private sector at market interest rates.

Conclusion

The U.S. Chamber believes that S. 1679 and the other proposals set forth in this statement would make an important contribution to limiting the growth in federal credit programs and restoring a better balance between the private and public sectors. We urge this Committee to consider carefully these reforms, and we recommend that Congress enact the appropriate legislation to put them in place.

Senator TRIBLE. Dr. Utt, I thank you very much for your statement. It's a good one. You have put forward a number of issues that ought to be pursued by the Congress. And I am pleased that you have decided that this, too, is an important step which will move us toward a responsible budget process to better decisions, hopefully, and I'm hopeful these steps can be taken and we can focus our attention on some of the other ideas you have advanced.

I thank you for being with us.

Dr. UTT. Thank you.

Senator TRIBLE. I do not have questions to propound to you at this time. Your statement was thorough and comprehensive, and I thank you very much.

Dr. UTT. Thank you, Senator, for giving us an opportunity to be here.

Senator TRIBLE. Our next witness is the Honorable Elmer Staats.

STATEMENT OF ELMER B. STAATS, FORMER COMPTROLLER GENERAL OF THE UNITED STATES AND CHAIRMAN, SUBCOMMITTEE ON BUDGET CONCEPTS AND PROCESSES OF THE COMMITTEE FOR ECONOMIC DEVELOPMENT [CED], ACCOMPANIED BY FRANK W. SCHIFF, VICE PRESIDENT AND CHIEF ECONOMIST OF CED

Senator TRIBLE. Mr. Staats, it's good to welcome you back to this committee. Our experience has been on the House side. I am glad that we could both be here today. I am pleased that your testimony today is as chairman of the subcommittee on budget concepts and processes of the Committee for Economic Development. I know that you have been a student of the budget process and have long advocated the need to strengthen that process so we can make more informed decisions in government.

Your testimony is most welcome.

Mr. STAATS. Thank you very much, Mr. Chairman. I am delighted to be back here. I have appeared before this committee many, many times. I have enjoyed our relationship very much, indeed.

I have a brief statement, Mr. Chairman, which I would like to read. I believe it can be done in about 10 minutes.

Senator TRIBLE. Please. Take as much time as you wish today.

Mr. STAATS. I might just add that part of the purpose here is to make visible these agencies—the extent of which the subsidy is involved in the credit programs. That is not done today. We have to go back and examine the basis for the legislation to know whether it's 6 percent, or 3 percent, or current market rate, or whatever the law may provide.

While these proposals are not of direct relevance to the legislation which you have before you today, I hope they will receive careful consideration by your committee in the future.

We see all of this as being related to the whole subject of attention to Federal credit. We thought it would be useful to outline all of the parts of our report which dealt with credit activities.

Senator TRIBLE. Mr. Staats, I thank you for that very thoughtful presentation. I would request that the studies to which you have referred be made a part of the record at this point, so we will have the full benefit of the studies of CED.

[The complete statement and studies follow:]

Testimony of

ELMER B. STAATS

Chairman, Subcommittee on Budget Concepts and Processes
of the
Committee for Economic Development

Mr. Chairman and Distinguished Members of the Committee:

The need for a truly comprehensive federal budget and a strong and honest federal budget process has been of key concern to me over many years. I served in the United States Bureau of the Budget for more than 20 years, holding the position of Deputy Director under Presidents Truman, Eisenhower, Kennedy and Johnson. I was appointed Comptroller General of the United States in 1966 and completed my 15-year term in March 1981. I also served as a member of the Commission on Budget Concepts whose 1967 report provided the basis for the introduction of the unified budget. As Comptroller General I testified in strong support of the Congressional Budget Act of 1974.

Today, I am appearing in my capacity as a trustee of the Committee for Economic Development (CED) and chairman of the subcommittee which developed the CED policy statement Strengthening the Federal Budget Process: A Requirement for Effective Fiscal Control that was issued in June of this year. With your permission, I would like to submit an Executive Summary of that statement for the record. Accompanying me is Frank W. Schiff, Vice President and Chief Economist of CED and project director for the budget study.

CED is a non-partisan, nonprofit organization of 200 business and educational leaders who develop reports and recommendations on major public policy issues on the basis of careful discussion and research. In preparing its recommendations, CED can typically draw on a great deal of relevant expertise among its own members. Thus,

the Subcommittee on Budget Concepts and Processes which I chaired included among its members and advisers three former budget directors and four former Cabinet members.

The central theme of the CED report is that an effective budget process needs to be based on full and clear information and that this in turn calls for a comprehensive, unified budget on which Congressional debates -- and votes -- can focus. The relevant section of the report dealing with this issue is attached. In particular, the report states that

> "We strongly believe that continued adherence to a comprehensive unified budget is essential to the effectiveness and credibility of the budget process. A unified budget that includes all activities by federally-owned entities is necessary to allow the Executive and Congress to make informed decisions on the overall fiscal and financial impact of federally-owned activities and to serve as a framework for tradeoffs among competing claims on federal fiscal resources."

While the approach advocated by CED is in line with the recommendations of the 1967 Budget Concepts Commission and the consequent introduction of the unified budget, the comprehensiveness of the budget has in recent years unfortunately been compromised through the use of off-budget outlays. In fiscal year 1984, according to CBO's latest estimates, net off-budget spending is expected to total $16 billion. Generally, between 80 to 90 percent of these off-budget outlays have been attributable to the Federal Financing Bank and particularly its ability to convert federal loan guarantees

into off-budget direct loans.[1/] The CED policy statement on the budget process therefore recommended that

> "To make the unified budget more fully comprehensive, ... activities now classified as off-budget should be incorporated in the unified budget. In particular, this should include the lending activities which are financed by the Federal Financing Bank."

The major feature of the bill you are considering here today -- S.1679, the Honest Budgeting Act of 1983 -- is precisely in line with CED's recommendations. Bringing the lending activities financed by the Federal Financing Bank into the unified budget would indeed make for more honest budgeting. It would allow a more accurate assessment of the overall impact of federal spending and lending operations on financial markets. Moreover, because the budget effects of the lending activities involved would be charged to the responsible federal agencies, Congress would be in a much better position to make informed decisions about priorities among the full range of federal lending programs.

I personally also feel that other key provisions of the bill, while not specifically taken up in the CED report, are desirable and, indeed, necessary to assure that CED's recommendations can be effectively implemented. Thus, it makes sense to require that loan assets of the type now being sold to the Federal Financing Bank by federal agencies for conversion into direct off-budget loans must

---

1/ This occurs when an agency extends the guarantee to the Federal Financing Bank rather than to private lenders and the Bank then extends direct loans to private borrowers on the basis of this guarantee.

also be offered for sale or guarantee to the Bank in the future, even though the resultant direct loans become "on-budget." Otherwise, there would be an incentive for federal agencies to evade budget process control of these transactions through sales of their securities in the open market.

I also approve of the provision that loan asset sales by federal agencies be treated as a means of financing rather than as negative outlays that can be used to reduce total budgetary spending chargeable to such agencies. The practice of treating the sales of loan assets by federal agencies as offsetting receipts has long been a major element of distortion in federal budgetary accounting and has often led to serious understatement of the actual volume of credit extensions by federal agencies.

I do, however, have a question regarding the bill's coverage. The bill is limited to guarantee programs of a type financed by the Bank between October 1, 1981 and September 30, 1984. Does this choice of dates mean that some relevant programs would not be covered? I certainly hope that nothing in the bill could be interpreted as providing exceptions from the basic CED recommendation for bringing into the unified budget all off-budget credit activities that have the character of direct loans.

I am not suggesting that all government-sponsored credit activities be counted in full as unified budget outlays. There are strong reasons, for example, not to include the full amount of VA loan guarantees, which facilitate financing transactions that are largely

private in character. (These guarantees, however, are properly included in the so-called credit budget that seeks to assess the overall impact of government-assisted credit programs on financial markets.) Precisely where to draw the line on what credit programs should or should not be included in the unified budget involves difficult decisions. These decisions, however, should be made on a rational and logically consistent basis. Certainly, the budget should include all programs that are comparable to the direct loans now counted as part of the unified budget.

The CED report recommends the establishment of a new Budget Concepts Commission, composed of representatives of the President, Congress and the public, that would consider ways of strengthening the conceptual and informational underpinning for budget decisions and enforcement. I strongly support this recommendation and believe that a key concern of such a Commission should be the development of precise criteria for determining the types of credit programs that should be counted in the unified budget.

I would also like to make one additional suggestion. Even if the proposed legislation were enacted and if a new Budget Concepts Commission were to provide further clarification of what should and should not be included in the budget, there are likely to be continuing questions as to whether future legislative provisions or administrative interpretations are in fact consistent with basic requirements for comprehensive federal budget coverage. It would be worth exploring

26-196 O—83——11

the idea of setting up an independent outside review board that might include both public and private sector members to monitor budget coverage and accounting practices on a continuing basis, somewhat along the lines in which private accounting practices are monitored by the Financial Accounting Standards Board.

Finally, Mr. Chairman, I would like to stress that bringing off-budget lending activities into the regular unified budget is only a first step toward more rational and effective budgetary treatment of federally-assisted credit activities. For the longer run, the CED report recommends a comprehensive approach in this area that is outlined in the section on "Controlling Federal Credit Activities." With your permission, I would like to submit a copy of this section for the record.

As an ultimate solution, the CED report envisages a two-tier approach. First, to permit improved budget process control over the total impact of federal credit programs on financial flows and markets, the report recommends that the credit budget be permanently made subject to most of the budget control procedures now applicable to direct spending. In particular, there should be a formal requirement that budget resolution ceilings on total new loan extensions and on loan guarantee commitments be made binding.

Secondly, to allow improved resource allocation decisions within the unified budget, the CED policy statement recommends greater experimentation with budget procedures that involve direct comparisons

between regular expenditures and the subsidy elements of credit programs. As a possible long-run solution, CED recommends careful exploration of a proposal to put all federal credit and guarantee activities in a national lending fund that would not be allowed to subsidize transactions or take risks on its own account but would receive reimbursement from government agencies equivalent to the cost of providing subsidized loans or guarantees on behalf of these agencies.

While these proposals are not of direct relevance to the legislation being discussed here today, I hope that they will receive careful consideration by your Committee in the future.

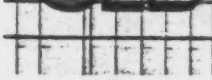
EXECUTIVE SUMMARY

Strengthening The Federal Budget Process:

A Requirement For Effective Fiscal Control

This executive summary is based on a statement on national policy by the Research and Policy Committee of the Committee for Economic Development.

June 1983



Executive Summary

Budget deficits and the budget process have moved to the center of national concern. This statement examines the evolution of the process Congress and the President use to formulate the federal budget. Its basic conclusion is that it is in the best interest of both the government and the nation to preserve, improve, and strengthen the basic elements of the Congressional budget process. We believe that not only is it possible to bring order to national fiscal affairs, but that it is vital for this nation to do so.

The report recommends strengthening key budget concepts and improving the information needed to allow policy makers to make reasonable budget choices. It also calls for specific improvements in the way budget decisions are made and enforced.

WHY WORRY ABOUT THE BUDGET PROCESS?

Unless the nation is able to bring about sharp reductions in projected budget deficits, the prospects for a sound recovery will be impaired. Failure to come to grips with the budget problem, moreover, would seriously threaten the long-term prospects for the future health of the economy and for the kinds of productivity gains that are needed to provide adequate employment and living standards for this country's citizens.

Success in bringing the budget under control rests fundamentally with the *political process*—the will of the people and the actions of their elected representatives. However, a strong federal *budget process* is essential to the effective functioning of political decision making in the areas of revenue and spending. Abandoning the basic budget process, the report concludes, would hinder rather than help efforts to bring the budget under control.

PROCESSES AND PROBLEMS

The enactment of the Congressional Budget and Impoundment Control Act of 1974 instituted a series of wide-ranging budget reforms. Before this time, no procedure required Congress to consider federal expenditures and revenues in combination.

The new law required Congress to vote twice each year, at two specific dates, on both the entire budget and major spending categories. The act also prescribed detailed timetables for all phases of the Congressional budget process, established budget committees in both the House and Senate, and founded the Congressional Budget Office to serve as Congress' principal source of fiscal information.

Even with the real improvements that have been made, Congress does not yet have a truly effective means of controlling actual budget expenditures and revenues. There is concern about the long delays that have become common at virtually every stage of the process. There is dissatisfaction with available budget information and with uncertainties about the budget's general meaning and scope. There is also the sense that the budget process is overloading Congress with money matters at the expense of substantive issues.

TOWARD MEANINGFUL REFORM

We strongly support continuation of the basic elements of the present budget process and believe that strengthening the process is vital for sound and effective economic policies.

To assure full consideration of needed improvements, we recommend the establishment of a new Budget Concepts Commission composed of members appointed by the President, Congress, and the public to study the concepts that underpin the federal budget. In addition, we recommend the establishment of a bicameral Congressional study group drawing on leaders of both the House and the Senate to deal explicitly with improvements in Congressional budget procedures.

IMPROVING BUDGET CONCEPTS AND INFORMATION

Congress should have the best possible information when making budget decisions. We believe that if Congress is to make optimal budget decisions, the budget needs to be both fully comprehensive and clearly understandable.

Budget Presentation. We believe that continued adherence to a comprehensive unified budget is essential. To make the budget more comprehensive, activities now classified as "off budget" should be moved back into the unified budget. We oppose the scheduled removal of Social Security from the unified budget and urge Congress to reverse recent actions calling for such removal by fiscal year 1993.

Economic Assumptions and Analysis. Reasonable and consistent economic assumptions are critical to the budgeting process. We favor requiring that both the House and Senate budget committees agree on a common set of economic assumptions for budget resolutions.

Both the Executive Branch and Congress should continue to make active use of the high-employment budget, or a similar concept, in analyzing budget developments. The high-employment budget concept, originated by CED in 1947, helps to distinguish between the impact of the budget on the economy and the effects of the economy on the budget.

Controlling Federal Credit Activities. Federal credit programs should be subject to most of the budget-control procedures now used in connection with direct spending. There should be a requirement for budget-resolution ceilings on total new-loan extensions and guarantees to be binding.

Congress and the Administration should develop means of allowing direct comparisons as well as trade-offs between direct-spending programs and the subsidy element of credit programs serving similar goals. In this connection, the report

recommends that the new Budget Concepts Commission study the possible establishment of a national lending fund that would be responsible for all federal loan and guarantee programs but would not be allowed to subsidize transactions or to take risks on its own account. Instead, government agencies sponsoring loans and guarantees would reimburse the lending fund to compensate it for the subsidy portion of federal credit activities.

Capital Budgeting. We are opposed to proposals for a formal capital budget outside the unified budget. There is a strong risk that a separate capital budget would become a giant loophole for evading budget disciplines. However, we do favor substantially greater focus on clearer presentation of investment-type programs and on "capital budgeting" approaches *within* the unified budget.

Tax Expenditures. Tax expenditures are reductions in federal revenue attributable to provisions in the tax law that allow special deductions, exclusions, or exemptions from gross income, or that provide a special credit, a preferential tax rate, or a deferral of tax liability.

We are opposed to a ceiling on total tax expenditures in the budget resolution. However, we believe that in cases where the relevant Congressional committees agree that tax expenditure programs and regular spending programs serve similar purposes, such programs should be subjected to joint reviews when feasible.

STRENGTHENING CONGRESSIONAL BUDGET PROCEDURES

Even if Congress has the best possible information and the best possible conceptual framework for budget options, it still must face up to making and enforcing specific budget decisions. We believe that the evolutionary changes in the process introduced in recent years have significantly strengthened the process and should be retained. However, some operational changes need to be made. In particular:

- The First Concurrent Budget Resolution should be made binding, thereby eliminating the need for a mandatory second resolution. Congress should, however, retain the option to pass a subsequent revised resolution if this appears necessary.
- The "elastic clause" should continue to be available as a needed means of providing a workable degree of flexibility in applying budget-process rules.
- The "outyear" targets in the budget resolution should be made binding.
- The shift toward the use of reconciliation in conjunction with the first budget resolution and its broadened application to existing entitlements and its implementation on a multiyear basis represent essential steps for making reconciliation effective. However, there should be some limitations on the scope of the reconciliation procedure, such as forbidding reconciliation bills to be vehicles for extraneous legislative proposals.
- Binding limits under budget resolutions, enforceable by points of order, should be tied to committee and subcommittee spending allocations, as well as to total spending.

Improving Congressional Timing. Because there are still many unresolved questions about two-year budget cycles, we do not favor an immediate across-the-board shift to biennial budgeting. Instead we recommend a gradual extension of the time period for budget and related decisions. This would involve active experimentation with two-year appropriations and other longer funding arrangements. If a high percentage of programs turns out to be suitable for two-year decision cycles, our recommendation would be consistent with an eventual move to a biennial budget. At a minimum, however, authorizing legislation should be for two years, and in some cases even longer.

We are opposed to any proposal under which Congress would be able to take up appropriations bills as soon as the deadline for the First Concurrent Budget Resolution has passed, whether or not the resolution has actually been approved by Congress. We believe that such a change would remove a major incentive for achieving timely budget resolutions and could significantly weaken the process.

To avoid unnecessary crises over continuing resolutions, we recommend that, with appropriate safeguards, a continuing but reduced appropriation be automatically put into effect at the start of the fiscal year for any account that has not yet received a regular appropriation.

Structural Realignments within Congress. While there should be careful study of possible realignments in Congressional committee structures and functions, the report is against any action that would abolish the House and Senate budget committees, undermine their essential functions, or otherwise weaken the budget process.

A Constitutional Amendment on the Budget. We are opposed to a constitutional amendment to balance the federal budget or to place specific limitations on budget outcomes. In our judgment, a constitutional amendment would be unworkable and would be likely to do more harm than good.

We believe that further strengthening of the Congressional budget process is a vital precondition for sound and effective fiscal and economic policies. Improvements of the present process along the lines indicated in this statement offer the best hope of bringing the budget under control.

SUBCOMMITTEE ON BUDGET CONCEPTS AND PROCESSES

Chairman
ELMER B. STAATS
Former Comptroller General of the United States
Washington, D.C.

ROY L. ASH
Los Angeles, California
JOSEPH W. BARR
Corporate Director
Arlington, Virginia
ALAN S. BOYD
President
Airbus Industrie of North America
JOHN B. CAVE
Executive Vice President and Chief Financial Officer
McGraw-Hill Inc.
PHILIP M. KLUTZNICK
Senior Partner
Klutznick Investments
ALONZO L. McDONALD
Chairman
Avenir Group, Inc.
[1] ROBERT R. NATHAN
Chairman
Robert R. Nathan Associates, Inc.
PETER G. PETERSON
Chairman
Lehman Brothers Kuhn Loeb, Inc.
ROCCO C. SICILIANO
Chairman
Ticor
CHARLES B. STAUFFACHER
Financial Consultant
Universe Tank Ships, Inc.
HOWARD S. TURNER
Chairman, Executive Committee
Turner Construction Company
SIDNEY J. WEINBERG, JR.
Partner
Goldman, Sachs & Co.
[1] FRAZAR B. WILDE
Chairman Emeritus
Connecticut General Life Insurance Company

*Nontrustee Members**

ROBERT S. BOAS
Chairman
Carl Marks & Company
CHARLES J. ZWICK
Chairman and Chief Executive Officer
Southeast Banking Corporation

[1] Voted to approve the policy statement but submitted memoranda of comment, reservation, or dissent.

*Nontrustee members take part in all discussions of the statement but do not vote on it.

ADVISORS

CAROL G. COX
President
Committee for a Responsible Federal Budget
R. C. PENNER
Resident Scholar
American Enterprise Institute
ALLEN SCHICK
Professor of Public Affairs
University of Maryland
CHARLES L. SCHULTZE
Visiting Professor of Research
Graduate School of Business
Stanford University
ALBERT T. SOMMERS
Senior Vice President and Chief Economist
The Conference Board

PROJECT DIRECTOR

FRANK W. SCHIFF
Vice President and Chief Economist
Committee for Economic Development

PROJECT STAFF

SEONG H. PARK
Economist
Committee for Economic Development
LUCILLE F. SAVERINO
Administrative Assistant
Committee for Economic Development

STAFF COUNSELORS

R. SCOTT FOSLER
Vice President and Director of Government Studies
Committee for Economic Development
KENNETH McLENNAN
Vice President and Director of Industrial Studies
Committee for Economic Development
NATHANIEL M. SEMPLE
Vice President, Director of Governmental Affairs, and Secretary, Research and Policy Committee
Committee for Economic Development

PROJECT EDITOR

CLAUDIA P. FEUREY
Vice President
Director of Information

RESEARCH AND POLICY COMMITTEE

Chairman
WILLIAM F. MAY

Vice Chairmen
WILLIAM S. EDGERLY/*Education and Social and Urban Development*
EDMUND B. FITZGERALD/*International Economy*
RODERICK M. HILLS/*Improvement of Management in Government*
ROCCO C. SICILIANO/*National Economy*

A. ROBERT ABBOUD, President
Occidental Petroleum Corporation

RAND V. ARASKOG, Chairman
and President
ITT Corporation

ROY L. ASH
Los Angeles, California

HARRY HOOD BASSETT, Chairman,
Executive Committee
Southeast Bank N.A.

ROBERT A. BECK, Chairman
The Prudential Insurance
Company of America

JACK F. BENNETT, Senior Vice President
Exxon Corporation

*OWEN B. BUTLER, Chairman
The Procter & Gamble Company

*THEODORE A. BURTIS, Chairman
Sun Company

FLETCHER L. BYROM, Retired Chairman
Koppers Company, Inc.

PHILIP CALDWELL, Chairman
Ford Motor Company

ROBERT J. CARLSON, President
United Technologies Corporation

*RAFAEL CARRION, JR., Chairman
Banco Popular de Puerto Rico

WILLIAM S. CASHEL, JR.
Vice Chairman
American Telephone
and Telegraph Company

JOHN B. CAVE, Executive Vice President
and Chief Financial Officer
McGraw-Hill, Inc.

EMILIO G. COLLADO, Chairman
Grace Geothermal Corporation

RICHARD M. CYERT, President
Carnegie-Mellon University

D. RONALD DANIEL, Managing Director
McKinsey & Company, Inc.

JOHN H. DANIELS, Retired
Chairman
National City Bancorporation

FRANK P. DOYLE, Senior Vice President–
Corporate Relations Staff
General Electric Company

W. D. EBERLE, President
Manchester Associates, Ltd.

WILLIAM S. EDGERLY, Chairman
and President
State Street Bank and Trust Company

*THOMAS J. EYERMAN, Partner
Skidmore, Owings & Merrill

FRANCIS E. FERGUSON, Chairman
Northwestern Mutual Life
Insurance Company

JOHN H. FILER, Chairman
Aetna Life and Casualty Company

WILLIAM S. FISHMAN, Chairman
ARA Services, Inc.

EDMUND B. FITZGERALD, President
Northern Telecom Limited

WILLIAM C. GREENOUGH, Retired
Chairman
TIAA and CREF

PHILIP M. HAWLEY, Chairman
Carter Hawley Hale Stores, Inc.

RODERICK M. HILLS, Chairman
Sears World Trade, Inc.

ROBERT C. HOLLAND, President
Committee for Economic Development

JAMES L. KETELSEN, Chairman
Tenneco Inc.

PHILIP M. KLUTZNICK, Senior Partner
Klutznick Investments

RALPH LAZARUS, Chairman,
Executive Committee
Federated Department Stores, Inc.

*FRANKLIN A. LINDSAY, Chairman
Engenics, Inc.

ROBERT W. LUNDEEN, Chairman
The Dow Chemical Company

J. PAUL LYET, Former Chairman
Sperry Corporation

G. BARRON MALLORY
New York, New York

WILLIAM F. MAY, Dean
New York University Graduate
School of Business Administration

ALONZO L. McDONALD, Chairman
Avenir Group, Inc.

JAMES W. McKEE, JR., Chairman
CPC International Inc.

E. L. McNEELY
La Jolla, California

*J. W. McSWINEY, Director
The Mead Corporation

RUBEN F. METTLER, Chairman
TRW Inc.

STEVEN MULLER, President
The Johns Hopkins University

NORMA PACE, Senior Vice President
American Paper Institute

VICTOR H. PALMIERI, Chairman
Victor Palmieri
and Company Incorporated

C. WREDE PETERSMEYER
Vero Beach, Florida

DEAN P.PHYPERS, Senior Vice President
IBM Corporation

JAMES Q. RIORDAN, Executive
Vice President
Mobil Corporation

HENRY B. SCHACHT, Chairman
Cummins Engine Company, Inc.

RICHARD R. SHINN, Former Chairman
Metropolitan Life Insurance
Company

ROCCO C. SICILIANO, Chairman
Ticor

RICHARD M. SMITH, Vice Chairman
Bethlehem Steel Corporation

ROGER B. SMITH, Chairman
General Motors Corporation

ELMER B. STAATS, Former Comptroller
General of the United States
Washington, D.C.

CHARLES B. STAUFFACHER
Financial Consultant
Universe Tank Ships, Inc.

WILLIAM C. STOLK
Easton, Connecticut

WILLIS A. STRAUSS, Chairman
InterNorth, Inc.

WALTER N. THAYER, Chairman
Whitney Communications Corporation

*W. BRUCE THOMAS
Vice Chairman of Administration
and Chief Financial Officer
United States Steel Corporation

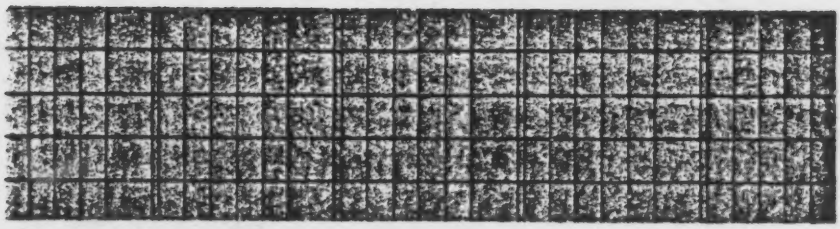
SIDNEY J. WEINBERG, JR., Partner
Goldman, Sachs & Co.

ALTON W. WHITEHOUSE, JR., Chairman
Standard Oil Company (Ohio)

*FRAZAR B. WILDE, Chairman Emeritus
Connecticut General Life
Insurance Company

RICHARD D. WOOD, Chairman and
President
Eli Lilly and Company

* Voted to approve the policy statement but submitted memoranda of comment, reservation, or dissent.



Chapter 2

Budget Concepts: Improving The Information Base For Budget Decisions

BUDGET PRESENTATION: THE NEED FOR COMPREHENSIVENESS, CLARITY, AND CREDIBILITY

Adequate and timely information is indispensable for an effective budget process. This part of our statement examines the information requirements for sound budget decisions and key areas for improvement.

MEANING AND PURPOSES OF THE BUDGET

Fundamentally, the federal budget is a plan or framework for making federal government spending and taxing decisions for a stated future period—at least one year but preferably a series of years. At the same time, it provides information about past government activities so that it can serve as a management as well as a planning tool. The budget should also be viewed as

- An instrument for setting priorities and allocating resources, both between the public and the private sectors and within the public sector
- A fiscal policy tool focused on the impact of federal spending and taxation on incomes
- A tool for assessing the impact of federal government operations on overall financial flows and for measuring total government borrowing needs
- A tool for monitoring federal government performance

- A focal point for public and Congressional debate on the President's fiscal objectives and programmatic proposals.

It is also important to be clear about what the budget *does not* do. It is not a measure of the *total* influence of federal policies on the economy: it does not take account of monetary, foreign exchange, and regulatory policies, for example. It does not measure the impact of all government spending and tax policies because state and local government operations are not directly included. Although information about the combined effects of federal, state, and local government fiscal operations ought to be made available on a regular basis, perhaps through the President's Economic Report, it is logical for the federal budget to include only those budget activities over which the President and Congress have direct control.

The federal budget should also not be viewed as a measure of the *full* impact—indirect as well as direct—of federal spending, tax, and credit activities on the economy. For example, when grants-in-aid are awarded to local governments on a matching basis, only the amounts paid by the federal government are counted. Similarly, induced effects of federal spending on private outlays are not counted as part of the federal budget total. In the case of credit activities, on the other hand, current practices result in measurement of indirect effects in some cases but not in others.

COMPREHENSIVENESS: THE NEED FOR A UNIFIED BUDGET

The budget has not one but a variety of purposes. Various crosscuts of the budget can be made to provide information that is relevant for such different purposes. Nevertheless, the 1967 Commission on Budget Concepts concluded that if budget policy is to be manageable and understandable, there must be one comprehensive, unified budget on which Congressional debates and votes can focus.

We strongly believe that continued adherence to a comprehensive, unified budget is essential to the effectiveness and credibility of the budget process. A unified budget that includes *all* activities by federally owned entities is necessary to allow the Executive Branch and Congress to make informed decisions on the overall fiscal and financial impact of federally owned activities and to serve as a framework for trade-offs among competing claims on federal fiscal resources. Crosscuts of budgetary information should complement the unified budget, not replace it.

The desirability of a unified budget has recently been challenged. Proposals have been made to exclude capital outlays and other elements from the present unified budget. The Social Security legislation that was passed at the end of March 1983 specifically provides for removal of Social Security from the unified budget in fiscal year 1993. Proponents of these

proposals argue that Social Security represents long-term concerns that require intensive consideration in their own right. Such activities, they say, should not be thrown into the same hopper with ordinary budget items and be subject to the year-to-year adjustments of budget priorities and totals.

The major difficulty with this argument is that it can be applied to a great many other elements of the budget as well, including defense spending and human-investment policies. It is likely, too, that once one program (Social Security) that is supported by earmarked trust-fund revenues is removed from the unified budget, demands will grow that similarly funded programs should also be removed from the budget.

Given the enormous difficulty of bringing overall federal budget activities under effective control, we believe that no activity should be fully exempt from justifying its outlays against those of others.* Moreover, assessment of the government's fiscal impact and borrowing needs requires information about all federal spending and receipts, whether or not this information is formally included in the unified budget. Breaking up the unified budget would lead to considerable public confusion when it comes to assessing the budget's overall economic and financial impact.

It is true that Social Security is a very special program. It is widely regarded as a long-term contract between the people and the government, and its basic features should clearly not be subject to annual adjustments governed by short-term considerations. A case can be made, however, that periodic marginal adjustments in cost-of-living allowances may be justified and would not necessarily run counter to the underlying long-term commitment of the Social Security system. As Alice Rivlin, director of the CBO, recently pointed out:

> In the long term . . . inclusion of Social Security in the unified budget does force the Congress to ask the right question: how much can the nation's economy afford for social insurance given competing claims on the economy and given the willingness of taxpayers to pay? Making Social Security a separate entity would unnecessarily narrow this question into "how high a level of benefits can payroll taxes support?"—a question that ignores competing claims, alternative tax sources, and the burden of other taxes.[1]

We oppose the scheduled removal of Social Security from the unified budget and urge Congress to reverse its recent action calling for such removal in fiscal year 1993. At the same time, we support showing Social

1. Letter from Dr. Alice Rivlin to Senator Pete V. Domenici, chairman of the Senate Budget Committee, 14 March 1983.

Security as a separate budget function within the unified budget, as has recently been suggested by the chairmen of the House and Senate budget committees and the director of the Office of Management and Budget in a joint letter to the chairman of the National Commission on Social Security Reform.[2]

Although removal of Social Security from the unified budget is scheduled for ten years from now, the comprehensiveness of the budget has in recent years already been somewhat compromised through the use of *off-budget* agencies. In fiscal year 1984, spending by these agencies is scheduled to total $17 billion on a current-services basis. For the most part, shifts of programs or agencies to off-budget status have been the result of arbitrary decisions and have been primarily designed to avoid full scrutiny of such programs under the budget process. The role of the Federal Financing Bank in converting on-budget federal loan guarantees into off-budget federal direct loans has been of particular concern. **To make the unified budget more comprehensive, we recommend that off-budget activities be incorporated in the unified budget. In particular, this should include the lending activities that are financed by the Federal Financing Bank.**

OTHER REQUIREMENTS FOR EFFECTIVE BUDGETARY INFORMATION

In addition to being comprehensive, the information included in the budget should conform to a number of requirements if it is to be fully effective as a tool for responsible budget policy making and enforcement.

- **Clarity.** The information should be clearly understandable to both lawmakers and the general public. Moreover, it should be relevant to the decisions that have to be made. Ambiguity of budget information is an invitation for budgetary abuse.

- **Future Orientation.** Budget information should adequately cover the multiyear implications of existing and proposed programs, including long-range commitments, contingencies, and the impact of alternative economic scenarios and demographic changes.

- **Comparability.** It should permit all comparisons needed for understanding governmentwide issues and policies and for establishing priorities among different activities and programs.

---

2. Letter to Dr. Alan Greenspan, chairman of the National Commission on Social Security Reform, from Representative James R. Jones, chairman of the House Budget Committee; Pete V. Domenici, chairman of the Senate Budget Committee; and David Stockman, director of the Office of Management and Budget, 3 December 1982. The signers of this letter strongly opposed taking Social Security out of the unified budget.

- **Credibility and Integrity.** The information should be credible, the economic assumptions should be reasonable, and the expectation for budgetary savings through proposed legislation and administrative actions should be realistic. The integrity of the information provided should be beyond question.

- **Timeliness.** Budget information should be available in time to provide Congress with the data essential to the evaluation of the President's budget requests, to permit full and adequate public discussion, and to enable Congress to act on the budget before the new fiscal year begins.

These requirements, of course, are not always mutually consistent. The desire to provide accurate information on the differential economic impact of different categories of federal transactions, for example, can come into conflict with the goals of clarity and simplicity. In designing particular budgets, compromises among competing requirements will inevitably have to be struck. The challenge is to design a budget that adheres to an optimum degree to the kinds of requirements we have cited.

CONTROLLING FEDERAL CREDIT ACTIVITIES

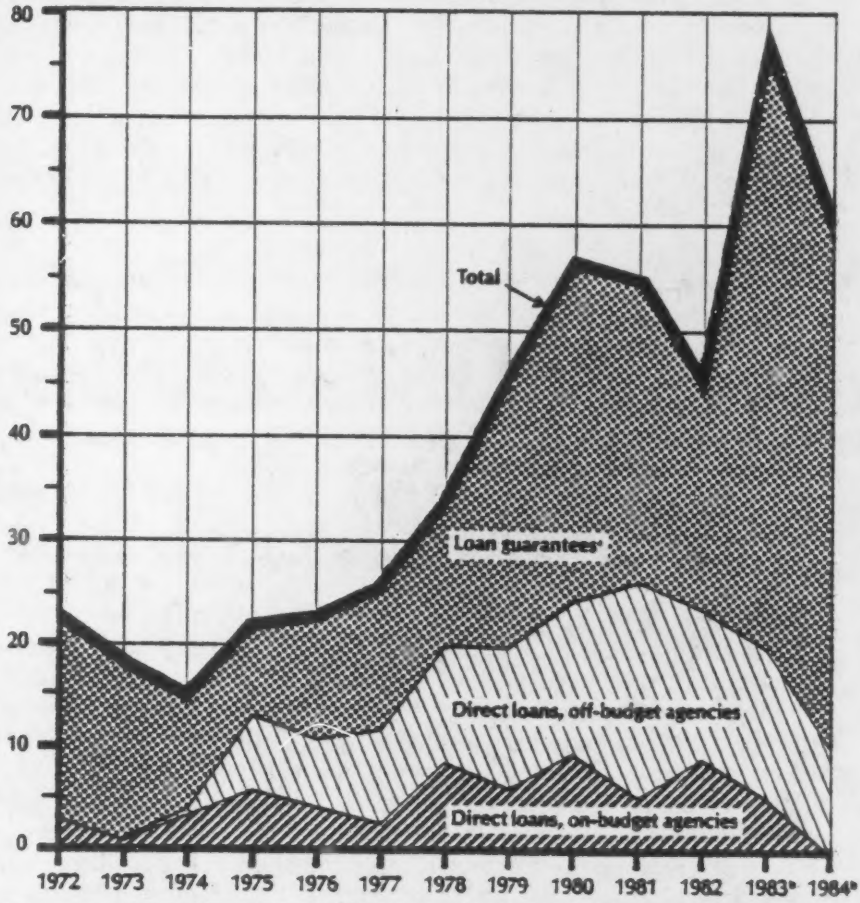
Since the late 1970s, federal credit programs, including both direct loans and loan guarantees, have expanded far more rapidly than direct federal spending (Figure 7).* Total net federal lending rose from $25 billion in fiscal year 1977 to $54.1 billion in fiscal year 1981. After a sharp decline in 1982 as a result of the combined impact of recession and high interest rates on federal mortgage loans, the level of credit is projected to increase to $75.4 billion in fiscal year 1983. For fiscal year 1984, the President's budget proposes a cutback to $59 billion. The budget estimates that the increase in net federal lending between 1977 and 1983 amounted to more than 200 percent, compared with a rise in regular federal outlays of 100 percent.[5] The burgeoning credit activity was concentrated in off-budget direct loans and in loan guarantees. In the past few years, moreover, several

5. If the third category of credit advanced under federal auspices, loans by government-sponsored enterprises, were included, the resulting aggregate would show an even faster rate of growth. Examples of such enterprises are the Federal National Mortgage Association (FNMA) and the Federal Home Loan Bank System (FHLBS). Because these enterprises are privately owned, their activities are not included in the budget totals. However, they carry out federally designed programs and receive tax and other special benefits that give their securities a preferred position in the securities market relative to those of completely private institutions.

FIGURE 7

Components of Net Federal Credit, Fiscal Year 1972 to Fiscal Year 1984

In billions of dollars



a. Primary guarantees, which exclude secondary guarantees and guaranteed loans acquired by on- and off-budget agencies.

b. Administration estimate.

SOURCE: Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 1984: Special Analysis F, Federal Credit Programs* (Washington, D.C.: Government Printing Office, 1983).

new types of loan-guarantee assistance programs have been initiated; these include the program to aid the commercialization of synthetic fuel production and the loan-guarantee assistance programs for New York City and the Chrysler Corporation.

In part, the upsurge of federal credit activities in recent years was undoubtedly related to the increased demand for federal credit assistance as general credit conditions tightened. In part, however, it also seems to reflect the fact that while direct federal spending was being subjected to progressively tighter controls through the Congressional budget process, federal credit activities were, at least until recently, largely exempt from the discipline of that process. This has posed a major challenge for the budget process.

THE CREDIT BUDGET

The only credit activities included in the unified budget and subject to the normal budget process are on-budget direct loans and default payments under loan guarantees. However, even on-budget direct loans are not adequately controlled through the regular budget process. Most are shown only on a net-of-repayments basis. While this measures the net drain on credit resources in financial markets, it masks the total volume of new lending activity, which is often unrelated to repayments. Moreover, by far the larger share of direct lending is off-budget, consisting mainly of loans made by the off-budget Federal Financing Bank to borrowers who have obtained a guarantee from a federal agency. These and other new commitments for loan guarantees are excluded from the unified budget except in cases of default.

To permit better overall control of federal credit activities, a partly overlapping *credit budget* was included in the President's budget starting in 1980. It provides estimates of all direct loans (both on- and off-budget) and loan guarantees, measuring these in terms of gross obligations (for direct loans) and gross new commitments (for guarantees). Congress has made increasing use of credit budget concepts and information in developing its budget resolutions. For example, the First Concurrent Budget Resolution for fiscal year 1983 included target ceilings for total credit budget direct loan obligations and loan-guarantee commitments. It also indicated how these totals should be allocated by budget functions. The Senate, moreover, made credit budget ceilings binding (that is, subject to a point of order if breached). The House voted for what was thought to be a comparable provision, but this was subsequently declared invalid on technical grounds.

The recent procedures to bring federal credit activities under better control have been developed largely on an experimental, ad hoc basis. As a

next step, we believe that credit programs should be permanently subject to most of the budget-control procedures now used in connection with direct spending. In particular, there should be a formal requirement that budget-resolution ceilings on total new loan extensions and loan-guarantee commitments be made binding. Because credit activities subject to this control process would be those included under the credit budget, the proposed ceilings would apply automatically to both off-budget and on-budget items. These ceilings would essentially be directed at limiting the impact of federal lending and guarantee programs on private credit markets.

Although the recommended procedure is clearly desirable as part of an overall effort to bring credit activities under better budgetary control, it would pose a number of problems if it were not followed by additional steps. One problem is to determine what the appropriate limits on credit extensions should be. Because different federal credit programs have widely varying impacts on private financial markets, it cannot be automatically assumed that particular federal credit programs will necessarily crowd out private credit activities on a one-to-one basis. For example, if Federal Housing Administration (FHA) loans were not available, private borrowers would to a considerable extent still turn to other lenders. Moreover, the degree of crowding out tends to vary with the overall strength of credit demands at different periods of time. Hence, considerable further study of the influence of federal credit activities on financial markets and submarkets is needed to assure that ceilings on such activities are set at levels that yield optimum economic results.[6]

INTEGRATING CREDIT AND DIRECT SPENDING DECISIONS

An even more serious problem stems from the fact that most of the transactions included in the credit budget are not part of the unified budget. Hence, budget control procedures based on the credit budget are not integrated with the regular Congressional budget process, which covers only unified budget transactions. There have, in fact, been some suggestions that it would make sense to separate the unified budget and the credit budget completely, mainly by taking on-budget direct loans (which are already counted in the credit budget) out of the unified budget. This would

6. Questions can also be raised regarding the range of activities to which budget control mechanisms directed at federal influences on credit markets should extend. Should federal support for secondary markets for loan instruments be included? Even more broadly, it could be argued that loan guarantees are merely a special case of a government guarantee of the performance of one or more parties in a private contract. Should all such guarantees be included in the budget, and if so, in what way? Questions of this type should be carefully examined by the proposed Budget Concepts Commission.

eliminate the existing overlap and provide two separate budgets for control purposes, one for spending and the other for lending and guarantees.

Under this arrangement, the credit budget total could then (with some adjustments) be added to deficits from spending and taxing operations to produce a measure of total federally induced drains on credit markets and thereby provide a basis for limiting such drains. But such a dual-budget system would also have a major disadvantage: it would, in practice, prevent direct comparisons and trade-offs between spending and credit programs having the same or similar purposes. This is a major shortcoming to the extent that there is concern with the budget's effects on incomes as well as on financial flows and with its role as an allocator of governmentally provided resources among competing uses. With separate spending and credit budgets, for example, there would be no way to make a direct comparison between an outright federal grant for education and a federal loan program for the same purpose. Yet, some of these loan programs are so highly subsidized that they are virtually equivalent to outright grants.

We recommend that in addition to relying on a credit budget, the Administration and Congress make strong efforts to develop an integrated approach to budget control that will, as far as possible, allow direct trade-offs between credit and spending programs within the unified budget.

A major obstacle to full integration of credit and spending programs is that these programs cannot be readily compared on a dollar-for-dollar basis. Of course, no one is suggesting that there should be a direct trade-off between a government expenditure, such as acquisition of a tank or a grant to a locality for school lunches, and a loan or guarantee program of an equal dollar amount. What is really needed is a comparison of the *subsidy* elements of loan or guarantee programs (including a risk premium) and direct spending.

How can this be done? One procedure that has been suggested would begin by weighting each dollar of federal credit (loan or guarantee) according to the discounted present value of the subsidy involved. (The President's fiscal year 1984 budget presents this type of information in detail.[7]) Actual loss experience under particular credit programs could also be taken into account in estimating the subsidy value. Each weighted amount would then be used as a guide to decisions on allocating budget resources to alternative uses. For example, when a spending committee is asked to reduce spending for programs under its jurisdiction by a specified amount, the budget committee might give it the option of achieving part of the cut by reducing

7. Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 1984, Special Analyses* (Washington, D.C.: Government Printing Office, 1983), F-54–60.

the subsidy element of a loan program rather than by basing the cut entirely on a reduction in direct spending.

As initial steps to help integrate federal credit activities into the regular budget process, we recommend, first, that further emphasis be placed on measuring the interest-subsidy elements in federal loans and guarantees and disseminating such information in readily understandable form and second, that there be experimentation with budget procedures that involve direct comparisons between regular expenditures and the subsidy elements of credit programs.

Even these procedures, however, would not *fully* integrate credit programs into the existing trade-off mechanism within the unified budget; outlay equivalents of credit and guarantee programs based on the present value of the subsidy would still not be formally counted as part of the unified budget. And unless the items to be traded off are automatically part of the same total, a trade-off procedure may be hard to enforce. The question thus arises whether a more straightforward approach could be developed under which the subsidy elements of credit programs would be explicitly incorporated in the unified budget and, consequently, in the regular budget control process.

A major problem with such an approach is that determination of the present value of a credit subsidy involves complex calculations and leaves room for considerable differences of opinion on what constitutes the best measure. Formal inclusion of computed credit-subsidy figures in the unified budget might thus create irresistible temptations to play games with budget numbers. This would run directly counter to the principle that the budget should be readily understandable and subject to as little manipulation as possible.

In theory, this difficulty could be overcome if the federal government were to stop making direct loans and guarantees altogether, if it provided those in need of subsidized credit with cash grants equal to the present value of the subsidy, and if it then left it up to the would-be borrowers to use these subsidy funds to obtain the needed credit on the desired terms directly from financial institutions. In actuality, of course, such an arrangement would probably not be feasible in most cases.

We believe, however, that a variation of this approach might prove practical and deserves careful exploration. It would involve the establishment of a national lending fund that would carry out all federal loan and guarantee activities but would not be allowed to subsidize transactions or take risks on its own. All government agencies requiring guarantee or direct lending programs for their clientele would have to pay sufficient sums to this fund to cover the subsidy elements of the credit programs plus a reserve

for defaults or delinquencies. All such payments would be made from appropriated funds. The subsidized credit programs would remain under the policy control of the agencies providing the funds. In many respects, fund charges to agencies for the subsidy elements of credit transactions could be regarded as analogous to rental charges that government agencies must pay to the General Services Administration for the use of office space. For optimum budget-process control, subsidies to the fund should be made available in the form of capital grants representing the present value of the subsidy, rather than through annual appropriations.[8]

The fund would still have to calculate what the amounts of such subsidy payments should be, but the estimate would not be purely hypothetical; rather, it would be based on a calculation of the added money the fund needed to operate without a deficit. Under this approach, all subsidy elements of federal credit programs would be subject to the appropriations process and would automatically be included in the unified budget as direct payments to the fund (which would itself be off-budget). They would thus be placed in clear and direct competition with other budget outlays.

As a possible long-run solution to the problem of making subsidized portions of federal loan programs directly comparable with regular budget expenditures, we recommend careful further exploration of the proposal to put all federal credit and guarantee activities in a national lending fund that would not be allowed to subsidize transactions or take risks on its own account but would receive reimbursements from government agencies equivalent to the cost of providing subsidized loans or guarantees on behalf of these agencies. Careful study of this proposal should be high on the agenda of the proposed Budget Concepts Commission.

A PHASED APPROACH

In summary, we favor a phased approach toward improving the treatment of federal credit activities under the budget process. The first step should be to strengthen the so-called credit budget and bring it more fully into line with the types of budget procedures used in connection with regular spending programs. This step is designed to permit improved budget-process control over the impact of federal credit programs on financial flows and markets. A second (or perhaps parallel) approach should gradually increase the comparability of credit and noncredit programs and allow more direct trade-offs between the two.

---

8. The case for providing subsidies in the form of capital grants should be further examined by the proposed Budget Concepts Commission. The commission should also study how risk premiums and losses should be handled under this scheme.

For the long run, we favor exploration of more far-reaching institutional changes, such as the creation of a loan fund through which credit activity can be fully integrated with the resource allocation procedures of the unified budget.

As an ultimate goal, we envision a two-tier approach. Primary control over credit activities and their impact on incomes and resource allocation would be through direct trade-offs between subsidy elements of credit activities and other elements of the unified budget. At the same time, we favor continuation of a secondary control mechanism to limit the impact of total federal lending and guarantee activities on private credit markets.

CAPITAL BUDGET ITEMS NEED LONGER TERM FRAMEWORK LOOK

Senator TRIBLE. One of the witnesses earlier stated that long-term loans do not belong in the unified budget, but instead in a separate capital budget. CED, I am told, just finished an in-depth study of these questions. How would you answer that suggestion?

Mr. STAATS. I can give you a short answer or a long answer. Maybe I can answer your question this way: We did consider very carefully the proposals made for a separate capital budget taken out of the unified budget. This is a very old proposal. It goes back, from my own personal knowledge, to the 1940's. We rejected that idea. We believe that capital spending ought to be subject to the same discipline that all of the rest of the budget is involved in.

However, having said that, we came to the conclusion that much more needs to be done by way of what we would call "capital budgeting" or "capital budget analysis." That is to say, we think that the budget should give higher visibility to the capital items that are in the budget. There is now an appendix to the budget, schedule D, which attempts to cover this. Part of the difficulty is to define precisely what is a "capital" or "noncapital" item.

But what may be more important is the difficulty that this schedule is added up after the budget is submitted to the Congress.

It is not a capital budget analysis in terms of looking at where the country's infrastructure needs may be both in the budget year and in a longer term framework. We think having this is terribly important because we do not have a rational basis for making judgments today on the total needs of the country, the total budget requirements for capital outlays. We can look at the Corps of Engineers, the Bureau of Reclamation, the highway program, agriculture—all of these are looked at separately, and are not looked at in terms of what is required by way of long-term investment.

So we find ourselves in a situation where, all of a sudden, we feel we are in a crisis on the highway program and we have to put through a special program. But there are many other parts of the public infrastructure that need the same kind of long-term look.

We think that this kind of longer term framework, if it were undertaken—it doesn't mean necessarily more total dollars; it does mean, though, that as you incrementally finance these programs

year to year, you will have a much better basis for rational decisions on the balance, on a national basis.

We think, also, there needs to be better guidance as to the cost-benefit analyses of these capital items that go into the budget.

Having said all of that, people who disagree with us on this say, "All right. Well and good. But it still means we won't get enough investment in capital items because it would be frozen out in competition." That doesn't, frankly, concern me. I don't think it concerns the CED. I think the point is, it is given visibility. If it is looked at in a longer term framework, then we would gamble that the Congress would make the right decisions, keeping it within the framework of the unified budget.

Senator TRIBLE. That's very helpful. I thank you for that answer.

Let me ask you another question. Several times in your testimony, discussing the reach of this legislation, you talked about off-budget credit activities that have the character of the direct loans. Credit programs that have "the character of," or quote "are comparable to direct loans.

Do you think these descriptions should apply to Federal loan guarantees that are exclusively financed in the private sector?

Mr. STAATS. With your permission, Frank Schiff will be glad to respond to that question.

Senator TRIBLE. Good. Let me ask one further question. Are they so similar to direct loans that they should be made into direct loans, and included on the budget?

Mr. SCHIFF. The major problem, currently, is that there are various transactions, as you know, that the Federal Financing Bank essentially converts from guarantees into off-budget loans. They become direct loans because it is the Federal Financing Bank that provides the funds. We are thinking of these activities as being activities that ought to be on-budget.

Senator TRIBLE. Rather than reaching out and bringing into the bank those credit activities that now are in the private sector?

Mr. SCHIFF. If they are fully private activities, of course, we wouldn't bring them into the budget. There are, however, various credit initiatives that are privately owned, but in the sense still have some connection with the Federal Government.

Senator TRIBLE. There are substantial Federal activities that have a private character.

Mr. SCHIFF. I think this is where we—where it's very difficult to know exactly where to draw the line.

Senator TRIBLE. I am giving you the opportunity to flesh out that observation.

Mr. SCHIFF. I noticed that this morning's testimony by the Office of Management and Budget made some suggestions in that regard. There are questions, for example, whether you want certain transactions in the budget—Mr. Staats referred to VA loans—which involve a lot of small retail transactions, where there is a substantial financing in the private sector—as one case where perhaps one doesn't necessarily want to put that into the budget in the same way as others, although it still ought to be considered in the credit budget. But there remain questions about the criteria for what should be included in the budget that, I think, are important to consider.

Some of your witnesses say, well, we could finance ourselves just as easily in the private market. And therefore, there is no reason to have any kind of Federal constraints.

I think one of the problems with that is that all of the agencies that utilize the market do affect the overall credit market. They affect the Treasury's ability to finance itself in the market. So you have another issue involved here, which has to do with the original purpose of the Federal Financing Bank and that is to get some regularity into Federal financing operations. I know there is some difference between what should be in the unified budget and what should be under control for credit purposes. That, I guess, is the reason for the so-called credit budget.

But I think it is important to know if these activities really are financed in the securities market, have a substantial impact, and might even be competing with other kinds of Federal financing, including direct Treasury financing. That, itself, can have an effect on Federal budget outlays in the end, because of the cost of borrowing through the Treasury.

So there is a consideration for not leaving out too many of these operations simply on the grounds that they go into private markets.

Mr. STAATS. Mr. Chairman, I listened with a great deal of interest to the presentation of the TVA. While I was Director of the Budget under President Eisenhower, I had responsibility for negotiating that legislation through the Congress.

Senator TRIBLE. Where were you when I needed you? You should have come up to the table. We would have made you a part of that discussion.

THE NATONAL LENDING FUND PROPOSAL

Mr. STAATS. What I wanted to say is I think it illustrates a point that Mr. Schiff just made here, and I think he said it quite correctly: If you go through the FFB and convert these guarantees into direct loans, they certainly ought to be part of the unified budget. The part of the discussion which I thought might have been emphasized a little bit more is, even if the TVA goes directly into the market, it ought to be subject to an overall credit budget because the function of the restrictions on credit activities is to limit the impact on the economy. It seems to me that that is quite appropriate and quite consistent with what was written into the 1959 legislation. The function of that provision in 1959 law was to say that the TVA, if it wanted to be independent, could go directly into the market, but you could not go directly into the market without notifying the Treasury.

The Treasury would then have the option of making loans directly to TVA so as to avoid the disruption in the financial markets. But you were quite correct in stating that nothing in this bill was to prevent that from happening.

But historically, the TVA has found the interest rates lower in many instances by going through the FFB or going directly to the Treasury. And they tried to go to the source that provided the lowest costs. But if they go through the FFB, and their transactions

are converted into direct loans, they certainly ought to be subject to the limitations.

Senator TRIBLE. Let me go back and follow up on our discussion with one more specific question, just to kind of get a better sense of your own view. Would a 100-percent Federal loan guarantee, in your judgment, have the "character" of direct loans that you talked about in your testimony?

Mr. STAATS. From the standpoint of its impact on the credit markets, it doesn't appear any different. Frank may want to add to that. He may want to differ.

But from my standpoint, the function of the credit budget is to look at the total credit operations of the Government in relationship to the credit in the private sector.

Senator TRIBLE. In macroeconomics, it surely may have the same impact; but it would have a different impact on the spending and borrowing requirements of the Federal Government.

Mr. STAATS. And you need to keep those two separate in your thinking. With respect to the one, you're talking about Federal credit limitation. The other, you're talking about outlays, and the outlays, of course, depends upon the direct loans.

Mr. SCHIFF. I might mention that as an ultimate solution, as Mr. Staats indicated in his testimony, we do make a distinction between total effects on the credit markets and effects on resource allocations. To measure total effects you use the credit budget that includes guarantees in full. Even with that budget, you still have to assess what the limits on the credit budget should be and what effect it will have on the market. It doesn't automatically mean that the credit budget total represents direct displacement of private credit. If you have all—there are all kinds of loans. For example, you have FHA loans. It doesn't mean that if someone doesn't get that loan then no loan would be made. Very likely some of the borrowers who would use an FHA loan would get the conventional loan.

So the question of how to decide at what level to set the credit budget is somewhat separate from the question of saying exactly what is the total impact. You have to set that level in relation to what you think the total impact would be. Then there is an additional question, and that has to do, really, with how do you compare the resource use of direct spending and credit activities. That's why we say ultimately you need to go to a somewhat different system than the one we have now, to get a direct tradeoff that makes the best sense.

What we are saying is that the real comparison ought to be made between direct spending and the subsidy elements of loans or guarantees. If you adopted this proposal that we think is worth considering, the national lending fund, what would happen is that different agencies would essentially contribute the amount of the subsidy element to that fund—that is the discounted present value of the subsidy plus administrative costs and charges for risk. They would get direct appropriation under the budget for the amounts they contributed.

The budget could then compare those appropriations with direct spending for tanks, school programs, and so forth. That's our ultimate solution.

Mr. STAATS. It would certainly give the subsidy more visibility. Congress would have to act positively, and the agency would have to justify it. The principle is really no different from that applied today on space in Government buildings. Each agency now has to come to Congress to pay the rent on the space that they occupy, whereas previously all that was under the General Services Administration. So what is suggested here is very similar in principle to that which is in existence today on use by agencies of the space that they occupy.

Senator TRIBLE. It's a handy analogy. It would not have occurred to me, I must confess.

Mr. STAATS. It's a good analogy.

Senator TRIBLE. It is, indeed.

Gentlemen, I appreciate your testimony today, and your testimony brings to a close a good day of hearings, morning and afternoon. You have underscored, I believe, that this legislation represents an important first step toward a more rational process. There are further steps that ought to be taken, and to that end I hope that this committee can work with you in pursuing the initiatives you have outlined.

Mr. STAATS. Thank you.

Senator TRIBLE. Thank you very much. The meeting is adjourned.

[Whereupon, at 3:20 p.m., the meeting was adjourned.]

1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Mortgage Bankers Association of America

James M. Wooten
President
(202) 861-6500

September 28, 1983

The Honorable Jake Garn
Chairman
Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This letter is submitted in connection with the Committee hearings held on September 19, 1983, to consider S 1679, the "Honest Budgeting Act of 1983." The Mortgage Bankers Association of America (MBA) respectfully requests that this letter be included in the hearing record.

MBA is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership is comprised of mortgage originators, mortgage investors, and a variety of industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios.

The "Honest Budgeting Act of 1983" would amend the Federal Financing Bank Act of 1973 to require that programs financed through the Bank be included in the Federal budget. The bill also would require that certain types of Federal obligations be offered for sale to the Bank in the future. It is regarding this latter requirement that MBA wishes to comment.

According to Section 3 of S 1679, the obligations that must be offered to the Bank would be future obligations that are of the same "type" as those obligations that have been financed through the Bank in the past. As we understand S 1679, and as we understand the intent of its sponsor, Senator Trible, the purpose of the provision in S 1679 is to preserve the jurisdiction of the Bank, after it is subject to the Budget, rather than to expand it. But the language of S 1679 does not define "type." The characteristics that are to be considered in determining future securities that must be included in the Federal Financing Bank are left to the Secretary of Treasury to define.

MBA believes it is important that Congress establish the fine line between preserving the Bank's place in the pattern of Federal financing and Federal credit on the one hand, and expanding the role of the Bank, perhaps inadvertently, to cover programs of Federal credit use that are not appropriate for the Federal Financing Bank on the other. We are concerned particularly that the mortgage-backed security program of the Government

National Mortgage Association (GNMA-MBS) not be strangled by a requirement that it work through the Federal Financing Bank.

GNMA was established in 1968, and its mortgage-backed security program was initiated soon after to introduce alternative sources of capital investment into the mortgage markets. Lenders, who originate mortgages, increasingly have sold these loans through the "secondary" market to permanent investors, rather than holding the mortgages themselves as long-term portfolio investments. This allows lenders in credit short areas to place their loans in the long-term capital markets, so that the lenders can reinvest their limited capital in additional local mortgages. Mortgage finance now depends upon accessibility to an efficient nationwide secondary market. The GNMA MBS program has helped to foster the secondary market and mobilize money on a nationwide basis, while providing the necessary assurance for investment in mortgages.

The GNMA MBS program is not Federal financing in the guise of guaranties. There are no net Federal dollars spent under the GNMA MBS program. The FHA and VA loans that serve as collateral utilize private funds. And, the guaranty fees collected by GNMA have provided the Government with a net return, after covering losses and administrative costs. The volume of securities issued and the prices obtained by the issuers efficiently reflect the rise and fall of demand in the real estate finance market, as homebuyers express their needs and abilities to purchase homes. Timing and immediate access to the capital market are crucially important for GNMA securities issues, and the Federal Financing Bank would severely inhibit this much-needed flexibility.

The continued high success of the GNMA MBS program rests upon the program being market oriented and responsive to the demands of the mortgage credit market. Restricting the GNMA MBS to the Federal Financing Bank route to the capital markets would cripple, if not destroy the program.

MBA appreciates this opportunity to comment on S 1679, and would be pleased to furnish additional information if needed.

Sincerely,

James M. Wooten

James M. Wooten

COMMENTS OF

THE NATIONAL ASSOCIATION OF MANUFACTURERS

ON S.1679, THE HONEST BUDGETING ACT OF 1983

SUBMITTED TO THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

OCTOBER 7, 1983

The National Association of Manufacturers (NAM) welcomes this opportunity to submit comments on S.1679, the Honest Budgeting Act of 1983. NAM represents over 13,000 member companies who employ over 75% of the nation's industrial workforce. NAM also has an affiliation with 158,000 businesses through its Associations Council and the National Industrial Council.

The National Association of Manufacturers commends this Committee for its efforts to require that programs financed through the Federal Financing Bank (FFB) be included in the unified federal budget. As you are well aware, the current

FY 1984 budget projections actually understate the federal deficit by as much as $16 billion due to spending which has been placed in a separate category and deemed "off-budget". As the majority of the off-budget spending is attributable to the transactions of the Federal Financing Bank, bringing FFB activities on-budget would ensure that budget resolutions provide a more concise and comprehensible financial statement of federal spending.

NAM has long endorsed bringing all federal spending into the unified budget. On January 29, 1981, Alexander Trowbridge, President of NAM, stated in testimony before the House Budget Committee that, "...off-budget loans by the federal agencies must be brought under control by the Congress...It is time to bring all federal spending transactions under one roof. Nothing is gained by placing some spending out of sight. That's like putting your credit card bills out of sight when it is actually your credit card that should be put away. Congress should consolidate all of its spending and borrowing responsibilities so that they can be reviewed and a true fiscal picture can be developed."

As recently as April 29 of this year, Arthur House, Vice President of Government and Industry Relations for CIGNA Corporation, reiterated NAM's position regarding a unified budget. He stated, "We continue to believe that all federal spending and revenues should be included in unified budget

totals. We contend that off-budget spending should be transferred on-budget all at once."

In addition to addressing the need to bring all spending into the unified budget, the Honest Budgeting Act remedies a number of other problems that have plagued federal credit activities in the past. In the last few years, Congress has attempted to bring the same discipline to its credit procedures as it has imposed on other spending activities. One way this has been achieved is through the creation of a credit budget now included in congressional budget resolutions. Generally, the credit levels were provided merely as recommendations and were nonbinding. However, as the importance of these programs became more apparent and the ability to effectively calculate the costs associated with credit activities improved, strong consideration was given to make the limits binding.

NAM believes that establishing binding credit levels is an important step towards the development of a responsible fiscal spending plan. Currently, the recommended credit levels are being circumvented by agency accounting practices. The Honest Budgeting Act would amend these practices, thus providing more effective enforcement of specified credit limits and making each agency more accountable for its credit activities. Currently, when a federal agency provides a direct loan to an individual or business, the transaction is credited against the amount allocated in the agency's budget and in the budget

resolution for that purpose. However, a change in the accounting procedure occurs when the agency sells the direct loan to the Federal Financing Bank. As explained in the Senate Budget Committee's Report No. 97-49 which accompanied S.Con.Res. 19 (the first budget resolution for FY 1982), "...the FFB purchases direct loans made by an agency or certificates of beneficial ownership (promise of repayment without transfer of the loan). This transaction is treated as an off-setting collection, reducing the on-budget outlays of the lending agency and increasing the off-budget outlays of the FFB." For example, if an agency has a $3 billion lending limit, it could make a $3 billion direct loan to an individual. If it then sells the $3 billion loan to the FFB, the final result is no reduction in the agency's outlays at the end of the transaction. The agency can then create another direct loan for $3 billion without exceeding its credit limit contained in the budget resolution.

S.1679 remedies this problem by requiring agencies to subtract these sales of direct loans or loan guarantees to the Federal Financing Bank from their outlays. Each FFB transaction would be treated as a "means of financing" and would be recorded in full in an agency's outlays. The result would be the discontinuation of the underreporting of credit activity by agencies accompanied by a more accurate accounting of the level of federal participation in the credit markets.

26-196 O—83——13

It would also force all credit transactions to be counted against an agency's credit limit established in a budget resolution in contrast to the current procedure of accounting only for those that remain on-budget.

Another problem which is at least addressed by the Honest Budgeting Act is the current ability of an agency to transform a federal loan guarantee into an off-budget direct loan. Many times, through current accounting procedures, congressionally mandated loan guarantees actually become federal direct loans. If an agency sells a loan it has guaranteed to the FFB, the FFB then provides the direct loan. The net result is the federal loan guarantee is transformed into an off-budget direct loan. NAM believes this practice counteracts the congressional intent of many loan guarantee programs and should be rectified. While S.1679 does not deny an agency the ability to transfer a guarantee into a direct loan, it does require agencies selling loan guarantees to the FFB to request an equivalent level of budget authority and charge the loan outlay to the agency's account. This should also enhance the ability of Congress to better calculate federal levels of loan activity and more effectively monitor agency lending levels.

As you consider this legislation further, we also believe you should examine current credit practices to determine if Congress is providing unintentional loan subsidies. Again, as stated in the Senate Report accompanying the FY 1982 first

budget resolution, "Federal direct loans, loan guarantees, and preferential interest rates or tax treatment afforded those loans are presumably intended to allocate credit in a manner different from that which would result without Federal influence. It must, therefore, be true that borrowers receiving guaranteed or direct loans receive terms more favorable than they would receive in private capital markets." If, as stated, a federal loan guarantee or direct loan includes a subsidy that would not be available without federal backing, then a federal loan guarantee that is transformed into a direct loan through the FFB may be receiving a double subsidy. It should be questioned whether this was the original intent of the drafters of the Federal Financing Bank Act. By requiring each credit transaction to be counted against an agency's allocation, it may be easier for Congress to determine if it is providing more of a subsidy to a borrower than was originally intended.

Finally, I would like to address the provision of the bill designated as the "no escape" clause. NAM agrees with Senator Trible that it is essential that all activities financed through the FFB between October 1, 1981 and September 30, 1984 continue to be financed through the FFB following adoption of the Honest Budgeting Act. This would prevent agencies from going outside the FFB to sell their securities in the open markets, thereby circumventing the budget control provided for

by the bill. It also maintains and reemphasizes the importance of the FFB as an efficient and effective financing tool. Congress should however consider the advisability of including the September 30, 1984 effective date in the "no escape" clause. This could significantly reduce future congressional efforts to control federal credit activities by excluding credit programs created after this date.

As mentioned by Elmer B. Staats in his testimony on behalf of the Committee for Economic Development, NAM was also requested by Senator Domenici to provide recommendations regarding the federal budget process. NAM's Fiscal and Monetary Policy Committee created working task forces which developed a detailed list of recommendations in the areas of multi-year budgeting, entitlements, reconciliation, impoundments and federal credit activities. I have attached a copy of the full report for your information and hope that our recommendations may be considered along with this legislation or as a part of other legislation that would strengthen and further define federal credit procedures.

Again, I appreciate this opportunity to present our views to this Committee. NAM supports your efforts and we look forward to working closely with you in the near future on these important issues.

National Association
of Manufacturers

ALEXANDER B. TROWBRIDGE
President

March 8, 1983

Senator Pete V. Domenici
United States Senate
Washington, DC 20510

Dear Senator Domenici:

The National Association of Manufacturers' (NAM) Fiscal and Monetary Policy Committee welcomes this opportunity to present our views on specific budget policy and procedural reform. In response to your letter of September 24, 1982, we created five task forces to examine some of the specific subjects you highlighted.

Specifically, small working groups met to evaluate progress in the areas of multi-year budgeting, impoundment procedures, entitlements, federal credit activity, and the reconciliation process. Knowledgeable representatives from Congress and the Office of Management and Budget were invited by several of the task forces to present their views on the current situation and to offer their recommendations for reform. As is evident by the following recommendations, many hours of consideration were devoted by our members to this project.

Prior to a discussion of the five specific areas of concern, it is necessary to reiterate an important point emphasized in past testimony. The NAM continues to believe that all federal spending and revenues should be included in the unified budget totals. Past and current projections of budget deficits have fallen short of stating the true amount of

federal indebtedness because a portion of federal spending, commonly referred to as off-budget outlays, is never included in budget total estimates. We contend that all off-budget spending should be tranferred on-budget all at once.

With this measure of budgetary control as a base, we present the following broader recommendations:

A. Federal Credit Activity

The National Association of Manufacturers has long recognized the importance and impact of federal credit activity on the national economy. The growth of these programs has contributed to the significant increase in government absorption of available credit. This in turn has made it more difficult for private industry to service its own borrowing requirements, which has resulted in slower rates of capital investment and job creation.

The magnitude of federal credit has been largely overlooked due to a lack of uniform accounting procedures among borrowers and lenders. Comprehensive statistics are essential to determine the full extent of federal credit liability. If the growth of these programs is to be effectively managed, we must begin to address the issue now. The National Association of Manufacturers' Fiscal and Monetary Policy Committee therefore recommends the following:

1. Congress, the Office of Management and Budget (OMB), the Congressional Budget Office (CBO) and the General Accounting Office (GAO) should agree on the definitions for all credit terminology. Currently, major differences exist in the interpretation of these

terms. A unified effort would produce the reliable data necessary to assess and establish responsible levels of federal credit activity.

2. Binding limits should be established in the budget resolutions for all federal credit activities. These limits should then be enforced through the congressional authorizations and appropriations processes, primarily through dollar appropriation limitations on credit activity. In order to unify federal spending and credit activities, an equivalent degree of control should be exercised over credit and direct spending programs.

   The language necessary to implement these changes has been developed and was included in the First Concurrent Resolution on the Budget for FY 1983. Similar language should become a standard part of the FY 1984 and subsequent budget resolutions and a part of the Congressional Budget and Impoundment Control Act of 1974.

3. The federal government's total credit liability should be included in both the President's budget and in the reports accompanying all budget resolutions emanating from Congress to highlight the extent of federal involvement in credit markets. In addition, default rates for individual programs should be included in the President's budget to assist in program management and congressional oversight activities.

4. Funds for credit activities should be subject to the same impoundment and reconciliation procedures that are included in the Budget Act for other types of federal funds.

5. As part of its oversight responsibilities, Congress should review all credit programs. Priority for federal funds should be established based on need, program efficiency and cost-effectiveness.

6. Comprehensive statistics on all federal lending activities should be compiled and a periodic analysis of all federal credit programs should be prepared. Development of a credit budget, studies requested by congressional committees, and computer scorekeeping capabilities developed by the Congressional Budget Office have all been helpful in providing the necessary information, but more is needed to establish an accurate assessment of our government's credit obligations.

Many of these recommendations stem from the realization that budgetary treatment of credit practices has been less than that for taxes or direct spending. Credit programs must be subject to the same scrutiny that is afforded by Congress for all federal spending.

B. Multi-Year Budgeting

The NAM supports the purpose and objectives of the Congressional Budget and Impoundment Control Act of 1974. However, the ability of Congress to adhere to the timetable of the Budget Act has declined markedly since the process was initiated, substantially curtailing the ability of Congress to review other legislative issues.

Our Fiscal Policy Committee endorses the concept and benefits of multi-year budgeting. Specifically, the Committee recommends a biennial budget process. The cycle should begin in the first session of each Congress. A budget resolution and all authorization and appropriations bills should be passed in the first year of the cycle, leaving the second year open for oversight and other legislation. In addition, the Fiscal Policy Committee believes that a number of issues related to the budget process need to be addressed and therefore recommends that:

1. A single set of economic assumptions should be agreed upon for all budget proposals by the Congress and the Administration.

2. The first concurrent budget resolution shall be made binding and the mandatory second concurrent budget resolution shall be eliminated.

3. Congress shall have the option to attach reconciliation instructions to concurrent budget resolutions.

4. Any modification of a budget resolution to increase spending shall require a super-majority vote.

C. Impoundment Procedures

We further believe that the impoundment procedures contained in the Congressional Budget and Impoundment Control Act of 1974 are adequate for providing congressional control over the impoundment of funds by the executive branch.

While this executive authority to impound funds may be useful to prevent unnecessary expenditures, it should not be used as a primary tool to reduce federal spending and deficit levels. Policy and program revisions to control the growth of federal spending should be accomplished through the authorization and appropriations processes.

NAM's Fiscal Policy Committee believes that the President should retain the authority to rescind and defer federal expenditures. Therefore, before any changes are made in the Budget Act regarding impoundment procedures, Congress should consider the following recommendations:

1. Line item veto authority should not be granted.

2. The provision of Title X, Section 1001(4) of the Budget Act, known as the "Fourth Disclaimer"[1], should be clarified. This provision attempts to define which federal appropriations are subject to impoundment by the President. The Congress, the Office of Management and Budget (OMB), and the General Accounting Office (GAO) differ in their interpretation of the duration and scope of this provision. We believe that:

   - The Fourth Disclaimer was intended to be a permanent, rather than a temporary, provision of law.

   - Only entitlements[2], as narrowly defined by Title IV Section 401(c)(2)(C) of the Budget Act, should not be subject to presidential impoundment.

---

[1]Fourth Disclaimer, as defined in the Congressional Budget and Impoundment Control Act, PL 93-344, 31 USC 1401:

Title X -
Section 1001. Nothing contained in the Act, or in any amendments made by this Act, shall be construed as -
(4) superseding any provision of law which requires the obligation of budget authority or the making of outlays thereunder.

[2]Entitlements, as defined in the Budget Act, PL 93-344 USC 1351:

Title IV -
Section 401.
(c) Definitions. -
(2) For purposes of paragraph (1), the term "spending authority" means authority (whether temporary or permanent) -
(C) to make payments (including loans and grants), the budget authority for which is not provided for in advance by appropriations Acts, to any person or government if, under the provisions of the law containing such authority, the United States is obligated to make such payments to persons or governments who meet the requirements established by such law.

Such term does not include authority to insure or guarantee the repayment of indebtedness incurred by another person or government.

D. Entitlement Reform

The NAM has long been concerned with the growth in entitlement programs and their impact on the economy. The "uncontrollable" nature of these programs has hindered numerous efforts aimed at bringing federal spending more in line with revenues.

Our Fiscal Policy Committee believes that entitlement reform should be undertaken to ensure that necessary programs accomplish their objectives in an efficient and cost-effective manner. This entitlement reform can be achieved through existing congressional oversight procedures. However, the procedures must be strengthened to ensure greater congressional accountability.

The business community has its own responsibility in these efforts. Recommendation and implementation of constructive alternatives will assist in reforming entitlement programs. Successful entitlement reform initiatives will lead to the achievement of the common goal of economic stability. Therefore, we recommend the following:

1. The congressional authorization committees should study all entitlement programs within their jurisdiction to determine which programs, if any, should remain as entitlements and which can be reconstituted as regularly authorized and appropriated programs. Pursuant to this task, Congress should determine if the original purpose of the program is still valid; if the eligibility criteria are too broad; and whether benefits are excessive.

2. Congress should not create any new entitlement programs. This would not preclude Congress from creating new programs. Rather, it would ensure congressional control of spending levels that would otherwise be relinquished if the benefits were established as entitlements.

3. Automatic cost-of-living adjustments for entitlement programs should be eliminated. Any periodic adjustments that Congress deems necessary should require a recorded vote.

4. A congressional study should be initiated to evaluate the feasibility of the private sector administration and/or management of federal entitlement programs.

5. Uniform scorekeeping measures should be adopted by both Houses of Congress. The current methods used by the House and Senate differ in the way they assess spending levels, thereby producing misleading comparisons.

E. Reconciliation

NAM's Fiscal and Monetary Policy Committee believes that in order to maintain the integrity of the congressional budget process, enforcement mechanisms, such as reconciliation, are necessary. However, as Congress has expanded its use of reconciliation in the past few years, it has become apparent the process needs to be strengthened and defined in order to help achieve fiscal discipline. Therefore, we recommend the following:

1. The first concurrent budget resolution should be made binding and the mandatory second concurrent budget resolution shall be eliminated. In addition, Congress shall have the option to attach reconciliation instructions to concurrent budget resolutions.

2. The current statutory ten day limit for Congress to complete action on a reconciliation bill or resolution, included in Title III, Section 310(d) of the Congressional Budget and Impoundment Control Act of 1974, is insufficient. The time restraints included in the Budget Act were associated with the need for Congress to adopt a second concurrent budget resolution and reconciliation, if mandated, prior to the beginning of a new fiscal year, October 1. With our recommendation to require only one concurrent budget resolution, these time constraints are mitigated. We look forward to working with Congress to determine a more appropriate timetable for committees to make their recommendations to fulfill reconciliation instructions and for final congressional action on a reconciliation bill or resolution.

3. The Budget Committees and Congress should codify the option to include provisions for reducing spending for both discretionary programs and entitlements in reconciliation instructions.

4. The amount of savings achieved in reconciliation bills shall be measured on the same basis used by the budget resolution which required them.

In conclusion, we would again like to thank you for this opportunity to present our proposals for budget reform. Our members gained a great deal of knowledge and a better understanding of the process while developing these recommendations. This insight will serve as an excellent basis for our future consideration of budgeting procedures.

Sincerely,